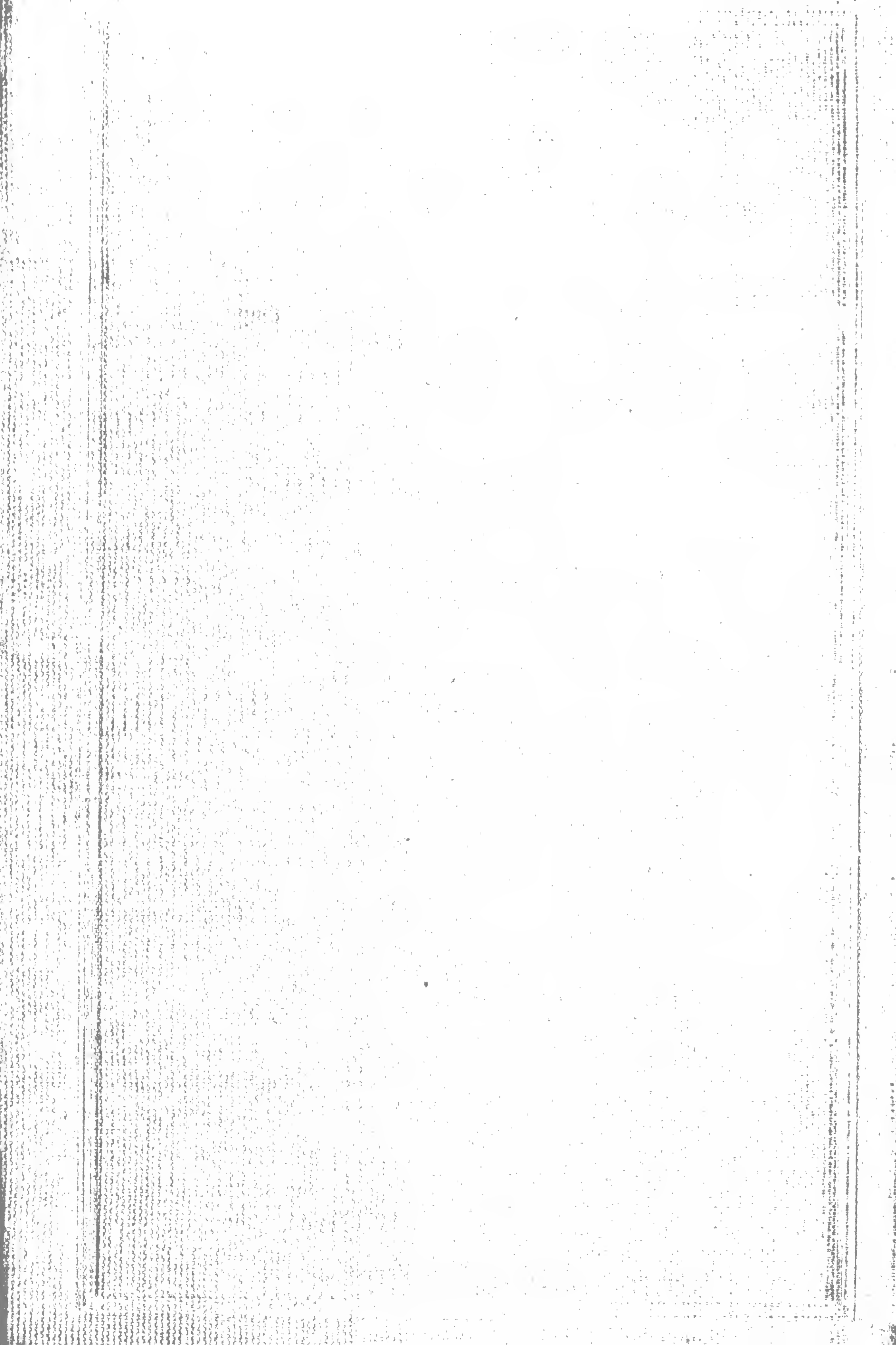

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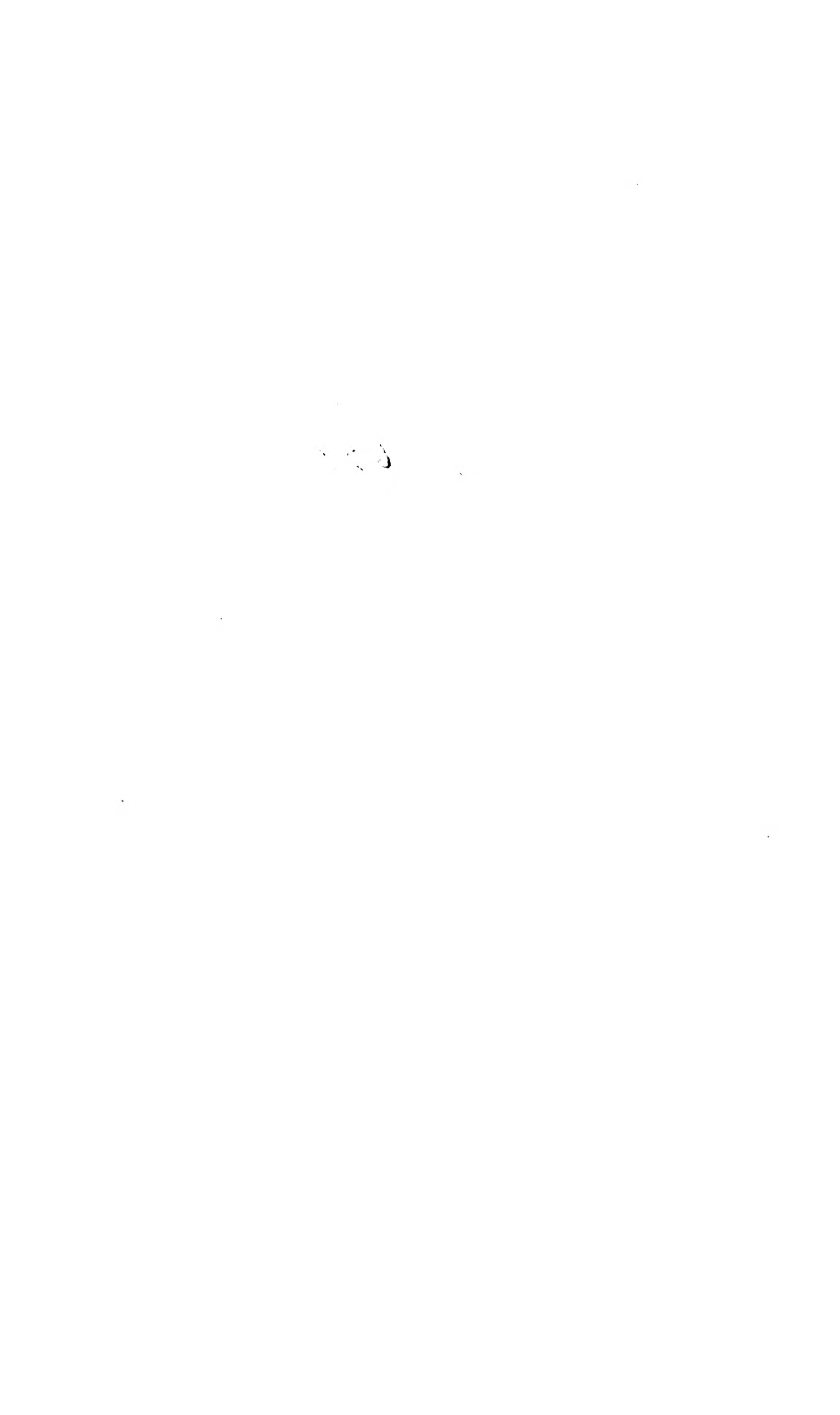

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No.......................................

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

KANSAS CITY LIFE INSURANCE COMPANY,
a corporation,

Appellant,

vs.

BERTHA E. BOWMAN,

Appellee.

Transcript of the Record

On Appeal from the District Court of the United States for the District of Idaho, Eastern Division.

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

KANSAS CITY LIFE INSURANCE COMPANY,
a corporation,

Appellant,

vs.

BERTHA E. BOWMAN,

Appellee.

Transcript of the Record

On Appeal from the District Court of the United States for the District of Idaho, Eastern Division.

NAMES AND ADDRESSES OF ATTORNEYS OF RECORD

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Salt Lake City, Utah,
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Pocatello, Idaho,
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IN THE DISTRICT COURT OF THE FIFTH JUDICIAL DISTRICT OF THE STATE OF IDAHO, IN AND FOR THE COUNTY OF BANNOCK

BERTHA E. BOWMAN,

Plaintiff,

vs.

KANSAS CITY LIFE INSURANCE COMPANY, a corporation,

Defendant.

COMPLAINT

Filed in the State Court, October 25, 1937.

The plaintiff complains and alleges:

I.

That the defendant now is and at all the times wherein it is hereinafter mentioned was a corporation organized and existing under and by virtue of the laws of the State of Missouri; that said corporation has complied with the Constitution and laws of the State of Idaho, and now is, and at all the times wherein it is hereinafter mentioned

was authorized to do and transact business within the State of Idaho.

II.

That heretofore and on or about the 25th day of February, 1926, the Continental Life Insurance Company was a corporation duly organized and existing under and by virtue of the laws of the State of Missouri; that said corporation had complied with the Constitution and laws of the State of Idaho, and at the date of the issuance of the insurance policy as hereinafter mentioned, and ever since said date until the said company was taken over by the defendant herein, as hereinafter alleged, was authorized to do business within the State of Idaho.

III.

That on or about the 25th day of February, 1926, Continental Life Insurance Company, St. Louis, Missouri, in consideration of the application of one John D. Bowman, and the payment of a premium of $87.58, issued and delivered to said John D. Bowman, its policy of insurance number 80,480, to which was attached a supplemental contract forming a part of said policy, providing for double indemnity benefits for accidental death, and thereby insured the life of the said John D. Bowman in the sum of $2,500.00, and agreed to pay Bertha E. Bowman, wife of the said John D. Bowman, the beneficiary therein named, the sum of $5,000.00, being double the face amount of said policy, in the event of accidental death of the said John D. Bowman as defined

in said supplemental contract and payable as therein provided, which said policy, supplemental contract for double indemnity for accidental death, supplemental contract for major surgical operations and dismemberment benefits and application of said insured, all forming a part of said policy are in words and figures as follows:

NUMBER
80480
CONTINENTAL
LIFE
INSURANCE
COMPANY
ST. LOUIS, MISSOURI

Business Policy
Ordinary Life Policy
Premiums Payable for Life
Non-Participating with Privilege of Exchanging for a Profit-Sharing Policy at the end of Twenty Years.
Life Income and Waiver of Premiums in Event of Total and Permanent Disability.
$2500
Insurance on the life of
JOHN D. BOWMAN
Annual Premium, $87.58
Date February 25, 1926

REGISTER OF CHANGE OF BENEFICIARY

Note—No change or designation shall take effect until endorsed on this policy by the Company at the Home Office

Date Endorsed	Beneficiary	Endorsed by

UNITED STATES OF AMERICA
CONTINENTAL
LIFE
INSURANCE COMPANY
St. Louis, Missouri.

NUMBER 80480 AGE 45

Agrees to Pay
Two Thousand Five Hundred Dollars

which is the face amount of this policy
to Bertha E. Bowman, Wife

immediately upon receipt of due proof of the death
of John D. Bowman the Insured.

PRIVILEGE OF EXCHANGING FOR A PROFIT-SHARING POLICY AT THE END OF TWENTY YEARS

This policy is issued on the non-participating plan, but the Company agrees to exchange it, without cost, for a Profit Sharing Annual Dividend Ordinary Life Policy for the face amount hereof at the end of twenty years from the date hereof, if all premiums shall have been duly paid. The new policy will contain the same benefits as this policy and will be subject to the continued payment of the same premium as is provided herein.

TOTAL AND PERMANENT DISABILITY BENEFITS

In addition to all other benefits provided by this policy, the Company will pay for the Insured the premiums required hereon, and will pay to the Insured a life income of Twenty Five Dollars per month, commencing six months after receipt of due proof that Insured has become totally and permanently disabled, as provided on the third page hereof.

PROFIT-SHARING INSTALMENT AND TRUST FUND PRIVILEGES

The Insured may change the mode of payment of the proceeds of this policy from payment in one sum to payment by instalments, as provided on the fourth page; hereof; such instalments will be increased by dividends as provided on said page.

The Insured may place the proceeds of this policy in trust with the Company to secure a guaranteed annual cash income, with dividends in addition thereto, as provided on the fourth page hereof.

Business Policy; Ordinary Life Policy; Premiums Payable for Life. Non-participating, with Privilege of Exchanging for a Profit-Sharing Policy at the End of Twenty Years; Life Income and Waiver of Premiums in Event of Total and Permanent Disability:

PREMIUM PAYMENTS

Grace in Premium Payments. A grace of thirty-one days, without interest charge, will be allowed in the payment of any premium after the first year, during which time this policy will continue in force.

Facility in Paying Premiums. Premiums are payable annually, in advance, but may be changed to semi-annual or quarterly payments in accordance with the Company's table of rates applicable hereto; and the Company will allow a change from one to another of such modes of payment upon the Insured's written request therefor on the Company's form.

All premiums shall be payable either at the Home Office of the Company in Saint Louis, Missouri, or to an authorized agent of the Company upon delivery of receipt signed by the President or Secretary and countersigned by such agent. If any premium is not paid on the date when due, this policy shall cease and determine, except as herein provided.

Reinstatement. If any premium is not paid on the date when due or within the period of grace, and this policy

has not been surrendered, the Company will reinstate the policy as of said due date at any time thereafter upon evidence of insurability satisfactory to the Company, and the payment of all arrears of premiums, together with the payment or reinstatement of any indebtedness on this policy on said due date, with interest thereon at the rate of six per cent per annum.

Automatic Premium Loans. The Company will advance any premium becoming due hereon and remaining unpaid on the last day of grace as a loan against this policy, provided the cash value of this policy at the end of the period covered by such premium, less any indebtedness on or secured by this policy, shall be sufficient to pay such premium together with interest in advance to the end of the period covered by such premium, and provided that the Insured shall have made written request for the automatic premium loan privilege either in the application for this policy or otherwise. If the net available cash value be insufficient to advance the premium then due, the Company will continue this policy in force until such cash value is exhausted, that is, for a period which bears the same ratio to the full premium period then ensuing as the net cash value bears to the premium then due, and if prior to the expiration of such reduced period, if any, the last due premium be not paid in full, all liability of the Company on this policy shall thereupon terminate, subject to notice as hereinafter provided.

Such premium loans shall be subject to the same terms and conditions as cash loans and the automatic payment of premiums under this clause will be discontinued at any time on receipt at the Home Office of the Insured's written request therefor. While this policy is thus kept in force, the insured may, without medical examination, resume payment of premiums as provided herein.

NON-FORFEITURE AND LOAN VALUES

Non Forfeiture Provisions. After the payment of premiums for at least two full years if any subsequent premium shall not be paid when due and remains unpaid at

the end of the period of grace the insured shall then have the following

OPTIONS:

(1) Extended Insurance, automatic. To have the insurance for the face amount hereof continued as non-participating term insurance reckoned from the due date of the unpaid premium; or

(2) Paid-up Life Insurance. To surrender this policy for paid-up life insurance; or

(3) Cash Value. To surrender this policy for its cash value.

If the Insured shall not within the period of grace make written request accompanied by this policy that it be endorsed for paid-up life insurance as provided in Option (2), or surrender the policy for its cash value as provided in Option (3) the insurance will be automatically continued as provided in Option (1).

The Company will allow a cash surrender value at any time on any paid-up life or paid-up term insurance.

Cash Loans. The Company will loan on the sole security of this policy, properly assigned, any sum within the cash value available at the end of the year in which the loan is made. The loan must be made before default in the payment of any premium and the Company will deduct therefrom any indebtedness hereon and any unpaid premiums for the year in which the loan is available. Interest at six per cent per annum will be payable in advance to the end of the aforesaid policy year and will thereafter be payable annually in advance. If interest is not paid when due it shall be added to the principal.

Loans will in like manner be made on the security of a paid-up life policy provided under Option (2) of non-forfeiture values for any amount up to the reserve thereon.

Failure to repay any loan or interest thereon shall not avoid the policy unless and until the total indebtedness hereon shall equal the then cash value of the policy nor

until thirty-one days after notice shall have been mailed by the Company to the last known address of the insured or any assignee of record.

Loan Insurance. The insured may cover any loan made under this policy by loan insurance on the following conditions: (1) The Insured shall furnish evidence of insurability satisfactory to the Company. (2) Loan Insurance takes effect upon delivery to the Insured of the Company's certificate therefor, and is payable upon receipt of due proof of the Insured's death. (3) The premium shall be computed at the attained age of the Insured at the time the loan insurance is made or renewed. (4) Loan insurance shall not extend beyond the next anniversary of the policy, but may under the same conditions be renewed from year to year. No loan insurance shall be made or renewed after age sixty. (5) Such loan insurance shall in the event of the death of the Insured be applied to the cancellation of the indebtedness. (6) If the loan insurance exceeds the indebtedness, the Company may cancel the excess and refund the unearned premiums.

PREMIUMS FOR EACH $100 of LOAN INSURANCE

Attained Age of Insured	20-30	31-40	41-45	46-50	51-55	56-60
Annual Premium	$0.90	$1.00	$1.20	$1.40	$1.80	$2.60

For a period of less than one year the premium shall be at the rate of one-tenth of the annual premium for each month or fraction thereof.

Reserve. The reserve on the life insurance benefit of this policy shall be computed on the American Experience Table of Mortality with interest at the rate of three and one-half per cent per annum and the preliminary term method modified on the twenty payment life basis. Subject to such modification, the first year's insurance hereunder is term insurance, purchased by the whole or part of the first year's premium. The non-forfeiture and cash values hereon are equivalent and are equal to the said reserve less a sum in no event in excess of 2.4 per cent of

the sum insured hereunder. After the twentieth year the said values will be equal to the full reserve.

TABLE OF GUARANTEED VALUES

No deductions from these values will be made for a surrender charge.

As this policy is for $2500, the cash and paid-up life insurance values hereunder are 2½ times the values in the table; the term of extended insurance applies to this policy without modification.

The non-forfeiture values in this table are available if premiums have been paid in full for the number of years stated, subject to any indebtedness, and will be adjusted proportionately for any semi-annual or quarterly premiums paid after the second policy year in addition to the premiums for complete policy years.

After Completion of Policy Year	Cash Value For Each $1000 of Face Amount	Paid-Up Life Insurance For Each $1000 of Face Amount	Term of Extended Insurance	
			Yrs.	Mos.
1st	None	None	None	
2nd	$ 15	$ 32	1	3
3rd	35	71	2	10
4th	55	111	4	4
5th	76	150	5	7
6th	98	188	6	9
7th	120	226	7	8
8th	142	262	8	6
9th	165	297	9	2
10th	188	331	9	8
11th	210	363	10	1
12th	233	394	10	5
13th	255	424	10	8
14th	278	453	10	10
15th	301	481	10	11
16th	324	508	11	0
17th	347	533	11	0
18th	370	558	10	11
19th	393	582	10	11
20th	416	605	10	10

Values will increase annually thereafter and an extension of this table covering later years will be furnished on application to the Home Office, if the policy does not terminate in the meantime.

ADDITIONAL PRIVILEGES

Change of Beneficiary. The Insured may at any time and from time to time, during the continuance of this policy, with the consent of the Company, subject to any assignment of this policy, change the beneficiary or beneficiaries hereunder by filing at the Home Office a written

request on the Company's form therefor, duly acknowledged, accompanied by this policy. Such change shall take effect only upon the endorsement of the same on this policy by the Company, whereupon all rights of the former beneficiary or beneficiaries shall cease. If any beneficiary shall die before the Insured, the interest of such beneficiary shall vest in the Insured, unless otherwise stipulated herein.

Control of Policy. This policy is issued with the express understanding that the Insured may, without the consent of the beneficiary, receive every benefit, exercise every right and enjoy every privilege conferred on the Insured by this policy.

Privilege of Exchange. This policy may be exchanged while no premium is in default or waived, for any other non-participating form of policy in use by the Company at the time this policy is issued, provided such policy shall contain no provision or benefit under which the insurance risk is greater than the risk assumed under this policy, on the following conditions:

If the premium rate per $1,000 of insurance is not thereby diminished, the change may be made without medical examination on the payment of such an amount as may be required by the Company.

If the premium rate per $1000 of insurance is thereby diminished, evidence of insurability satisfactory to the Company must be furnished, and adjustment shall be made of the difference between the reserves of the respective policies.

The new policy shall be written at the same age, bear the same date, and be for an amount not in excess of the face amount of this policy.

TOTAL AND PERMANENT DISABILITY BENEFITS

The Company will pay for the insured the premiums required on this policy for every policy year, commencing with the anniversary next following the date of approval

by the Company of proof that the Insured, before attaining the age of sixty years, has become totally and permanently disabled as hereinafter defined.

The Company will also pay to the Insured a monthly income of $10 for each $1,000 of the face amount of this policy if the Insured shall become totally and permanently disabled as hereinafter defined, before attaining age sixty. The first payment of such income shall be made six months after receipt and approval of such proof and subsequent payments will be made monthly thereafter as long as the Insured lives and suffers such disability.

The sum payable in any settlement of this policy shall not be reduced by income payments nor by premiums waived under the above provisions and this policy will continue in full force to maturity with loan, cash and other guaranteed values increasing from year to year in like manner as if the premiums were being duly and regularly paid by the Insured. If there be any indebtedness on this policy the interest thereon will be deducted from any income payment or payments.

Total and permanent disability may be due either to bodily injury or to disease which has existed for not less than sixty days and which must occur and originate while this policy is in full force after one full year's premium has been paid.

Disability shall be deemed to be total, (a) whenever the Insured is totally disabled by bodily injury or disease so that the Insured is prevented thereby from engaging in any occupation whatsoever for remuneration or profit; or (b) if the Insured has suffered the total and irrecoverable loss of the sight of both eyes or of the use of both hands or of both feet or of one hand and one foot.

Disability shall be presumed to be permanent whenever the Insured will presumably be so totally disabled for life.

The Company may from time to time demand due proof of the continuance of such disability and the right to examine the person of the Insured, but not oftener than once a year after such disability has continued for two full years. Upon failure to furnish such proof, or if it

shall appear to the Company that the Insured is able to engage in any occupation whatsoever for remuneration or profit, income payments shall cease and the Insured shall be required to pay the premiums thereafter becoming due on this policy in accordance with the original terms hereof.

These disability benefits will not apply if the disability of the Insured shall result from self-inflicted injury or from military or naval service in time of war, nor to disability occurring while this policy is continued in accordance with any non-forfeiture option.

In the event of the total and permanent disability of the Insured, the provisions of this policy entitled "Privilege of Exchange," and any endowment option, will not be available.

The annual premium for the total and permanent disability benefits is $6.27 and is included in the premium stated in the consideration clause of this policy.

The provisions for total and permanent disability benefits and the premium therefor may be discontinued at any time on written request of the Insured accompanied by the policy for endorsement. In any event any premiums payable after the anniversary of this policy nearest to the sixtieth anniversary of the date of birth of the Insured shall be so reduced.

MISCELLANEOUS PROVISIONS

Incontestable After One Year, as follows: This policy is free from conditions as to residence, occupation, travel, place of death and military or naval service in time of peace or war, and shall be incontestable after one year from date of issue if the premiums are duly paid, provided, however, that the benefits for total and permanent disability and those granting additional insurance specifically against death by accident, if any, attached to or incorporated in this policy shall become void and cease to be in force for the causes and under the conditions as stated therein.

If the age of the Insured has been mis-stated the

amount payable under this policy shall be such as the premium paid would have purchased at the correct age of the insured. The Company will admit the age of the Insured when furnished with satisfactory evidence of the date of birth.

Assignment. Any assignment of this policy must be made in duplicate and both documents sent to the Home Office, one to be retained by the Company and the other to be returned. The Company assumes no responsibility for the validity of any assignment.

Non-Participating. This policy is issued on the Non-Participating plan and the cost of the insurance does not depend on the profits or surplus of the Company.

General Provisions. All benefits under this policy are payable at the Home Office of the Company in Saint Louis, Missouri, and proof of interest of claimant will be required. Due proof of death or application for any other benefit or settlement hereunder must be furnished to the Company at its Home Office in writing. Any indebtedness herein to the Company will be deducted from any settlement of this policy or from any cash surrender value available hereunder; the period of extended insurance and the amount of paid-up life insurance provided in Options (1) and (2) of non-forfeiture provisions will be such as the net cash surrender value, after deducting any indebtedness hereon, will purchase at the attained age of the Insured at net single premium rates according to the reserve standard named herein. In the settlement of this policy as a death claim any unpaid premium for the current policy year in which death occurs shall be considered an indebtedness hereon to the Company.

Payment of the cash value or the making of a loan, except for the purpose of paying renewal premiums hereon, may be deferred for a period of ninety days after application shall have been made therefor.

Only the President or Secretary has power in behalf of the Company to make or modify this or any contract of insurance, or to extend the time for paying any premium, and the Company shall not be bound by any promise or

representation heretofore or hereafter made unless made in writing by one of said officers.

Death by self-destruction, while sane or insane, within one year from date hereof, shall limit the amount payable by the Company to the total premiums paid on this policy.

Entire Contract. This policy and the application therefor, copy of which is attached hereto, constitute the entire contract. All statements made by the Insured shall, in the absence of fraud, be deemed representations and not warranties, and no such statement shall avoid the policy unless it is contained in the written application herefor.

CONSIDERATION

This insurance is granted in consideration of the application herefor, which is made a part hereof, and of the payment in advance of Eighty-Seven and 58/100 Dollars being the premium for the term ending on the 25 day of February 1927, which is term insurance and for the legal reserve, if any. The insurance will be continued thereafter upon the payment of the.........................annual premium of Eighty-Seven and 58/100 Dollars on before the 25th day of February in every year during the continuance of this policy.

After delivery of this policy to the Insured, it takes effect as of the date stated below.

IN WITNESS WHEREOF, the CONTINENTAL LIFE INSURANCE COMPANY has caused this policy to be signed by its proper officers at Saint Louis, Missouri, this 25 day of February, 1926.

J. DeWITT WILLS EDMUND P. NELSON
Secretary President
Countersigned Examined
(SEAL) Assistant Secretary

INSTALMENT AND TRUST FUND PRIVILEGES

The Insured may direct in writing that settlement of the proceeds of this policy shall be made by payment in instalments in accordance with any of the following options

instead of by immediate payment in one sum at maturity, if the policy is not assigned. The beneficiary can neither assign nor commute unpaid instalments unless such right is given by the Insured to the beneficiary. If the beneficiary should die before the total specified number of instalments certain shall have been paid and if there be no contingent beneficiary designated by the Insured or by the beneficiary after the death of the Insured, the remainder of these instalments will be commuted at the rate of three and one-half per cent per annum and paid in one sum to the beneficiary's estate, unless otherwise directed by the Insured.

The beneficiary upon the death of the Insured, provided the Insured has not otherwise directed, or the Insured upon surrender for the cash value may direct settlement of the whole or any part of the proceeds of this policy in accordance with any one of the following benefits:

Annual, Semi-annual or Quarterly Instalments computed at the rate of three and one-half per cent per annum compound interest, will be paid upon request, in lieu of monthly instalments.

Selection of any of the aforesaid methods of settlement of the proceeds of the policy shall take effect only when endorsed on this policy by the Company. After endorsement the policy will be returned to the Insured.

Payment of the first instalment shall be made immediately upon receipt of due proof of the death of the Insured, and subsequent instalments shall be paid annually, semi-annually, quarterly or monthly thereafter as may have been directed.

In no event shall any option be available if the amount of each instalment payable thereunder is less than Ten Dollars.

The following tables are based upon a policy of $1,000 and will apply pro rata to the amount payable under this policy.

MONTHLY INSTALMENTS FOR DEFINITE NUMBER OF YEARS

Number of years During which Monthly Instalments are paid	1	2	3	4	5	6
Amount of Monthly Instalments per $1000 of Proceeds	$84.75	$43.10	$29.24	$22.26	$18.18	$15.34

Number of years During which Monthly Instalments are paid	7	8	9	10	11	12
Amount of Monthly Instalments per $1000 of Proceeds	$13.39	$11.91	$10.79	$9.87	$9.09	$8.47

Number of years During which Monthly Instalments are paid	13	14	15	16	17	18	19
Amount of Monthly Instalments per $1000 of Proceeds	$7.94	$7.49	$7.13	$6.77	$6.46	$6.20	$5.97

Number of years During which Monthly Instalments are paid	20	21	22	23	24	25	
Amount of Monthly Instalments per $1000 of Proceeds	$5.78	$5.57	$5.40	$5.24	$5.10	$4.96	

ILLUSTRATION: If payment is to be made by monthly instalments for twenty years, the amount of each installment will be $5.78 for each $1,000 of proceeds.

CONTINUOUS MONTHLY INSTALMENTS FOR DEFINITE NUMBER OF YEARS AND THERE-AFTER DURING BENEFICIARY'S LIFETIME

Definite Number of Years Specified	Age of Beneficiary at Maturity of Policy								
	15 and Under	16	17	18	19	20	21	22	23
5 years	$4.00	$4.02	$4.03	$4.05	$4.07	$4.09	$4.11	$4.13	$4.15
10 years	$3.95	$3.96	$3.98	$4.00	$4.02	$4.04	$4.06	$4.08	$4.10
15 years	$3.88	$3.89	$3.91	$3.92	$3.94	$3.95	$3.97	$3.99	$4.01
20 years	$3.80	$3.82	$3.84	$3.86	$3.88	$3.90	$3.92	$3.94	$3.96
	24	25	26	27	28	29	30	31	32
5 years	$4.17	$4.20	$4.22	$4.25	$4.28	$4.30	$4.33	$4.37	$4.42
10 years	$4.12	$4.14	$4.17	$4.19	$4.22	$4.25	$4.28	$4.31	$4.34
15 years	$4.03	$4.05	$4.08	$4.10	$4.13	$4.16	$4.20	$4.24	$4.28
20 years	$3.98	$4.00	$4.02	$4.04	$4.06	$4.09	$4.12	$4.15	$4.18
	33	34	35	36	37	38	39	40	41
5 years	$4.46	$4.51	$4.56	$4.62	$4.68	$4.74	$4.80	$4.87	$4.95
10 years	$4.38	$4.43	$4.49	$4.55	$4.61	$4.66	$4.72	$4.79	$4.86
15 years	$4.32	$4.37	$4.41	$4.46	$4.51	$4.56	$4.61	$4.67	$4.73
20 years	$4.22	$4.26	$4.30	$4.34	$4.38	$4.42	$4.47	$4.52	$4.57
	42	43	44	45	46	47	48	49	50
5 years	$5.02	$5.11	$5.19	$5.29	$5.38	$5.49	$5.60	$5.72	$5.85
10 years	$4.93	$5.01	$5.09	$5.18	$5.27	$5.37	$5.47	$5.57	$5.67
15 years	$4.79	$4.86	$4.93	$5.00	$5.08	$5.16	$5.24	$5.32	$5.40
20 years	$4.62	$4.68	$4.73	$4.78	$4.84	$4.90	$4.96	$5.01	$5.07
	51	52	53	54	55	56	57	58	59
5 years	$5.98	$6.13	$6.29	$6.45	$6.62	$6.80	$7.00	$7.21	$7.43
10 years	$5.79	$5.91	$6.04	$6.17	$6.30	$6.45	$6.60	$6.75	$6.91
15 years	$5.49	$5.57	$5.66	$5.75	$5.85	$5.95	$6.04	$6.13	$6.22
20 years	$5.13	$5.19	$5.25	$5.30	$5.35	$5.40	$5.44	$5.49	$5.53

	60	61	62	63	64	65	66	67	68
5 years	$7.66	$7.90	$8.16	$8.44	$8.73	$9.04	$9.36	$9.69	10.05
10 years	$7.07	$7.24	$7.41	$7.58	$7.75	$7.92	$8.09	$8.26	$8.42
15 years	$6.31	$6.39	$6.47	$6.55	$6.63	$6.70	$6.77	$6.83	$6.88
20 years	$5.56	$5.59	$5.62	$5.65	$5.67	$5.69	$5.71	$5.72	$5.73

	69	70	71	72 and Over
5 years	$10.42	$10.80	$11.19	$11.59
10 years	$ 8.58	$ 8.74	$ 8.90	$ 9.06
15 years	$ 6.93	$ 6.97	$ 7.01	$ 7.04
20 years	$ 5.74	$ 5.75	$ 5.75	$ 5.75

ILLUSTRATION: If at the death of the Insured the beneficiary should be thirty years of age last birthday, the amount of each monthly instalment will be $4.12 payable thereafter for a period of twenty years and as long thereafter as the beneficiary shall live.

TRUST FUND PRIVILEGE

The whole or a part of the proceeds of this policy, but not less than $1,000, may be placed in trust with the Company during a specified period or until the death of the beneficiary. The Company will pay a guaranteed income thereon at the rate of three and one-half per cent per annum. The first payment of income shall be made one year after maturity of this policy and subsequent payments annually thereafter. Upon the termination of the trust, the amount thus placed in trust shall be paid to the beneficiary or to the beneficiary's estate unless otherwise directed by the Insured.

DIVIDENDS UNDER INSTALMENT AND TRUST FUND PRIVILEGES

Each instalment and each payment of interest will be increased by such dividends from the interest earnings as may be apportioned by the Company.

CONTINENTAL LIFE INSURANCE COMPANY ST. LOUIS, MISSOURI

Supplemental Contract attached to and forming a part of the Company's Policy No. 80480 on the life of John D. Bowman the Insured. Face Amount of Policy $2,500.

DOUBLE INDEMNITY BENEFITS FOR ACCIDENTAL DEATH

The Company agrees to pay Five Thousand Dollars which is double the face amount of the aforesaid policy and in lieu thereof, to the beneficiary named therein, in event of the accidental death of the Insured as hereinafter defined.

The additional sum payable in event of the accidental death of the Insured shall be due if the Company shall receive due proof that such death occurred during the premium paying period before default in the payment of any premium, before the allowance of any total and permanent disability benefit, and prior to attaining the age of sixty years, and that such death resulted directly and independently of all other causes from bodily injuries, effected solely through external, violent and accidental means, and occurred within ninety days from the date of the accident, except that this double indemnity benefit shall not be payable if the Insured's death shall result directly or indirectly, wholly or partly from suicide, whether sane or insane, from poisoning, infection or any kind of illness or disease, or from bodily injuries received while engaged in military or naval service or from participating in aeronautics or submarine operations.

The annual premium for this double indemnity benefit is $3.75 and is included in the premium stated in the consideration clause of the policy.

The provisions for double indemnity benefits and the premiums therefor may be discontinued at any time on written request of the Insured accompanied by the policy for endorsement. In any event any premiums payable after the anniversary of this policy nearest to the sixtieth

anniversary of the date of birth of the Insured shall be so reduced.

IN WITNESS WHEREOF the Continental Life Insurance Company has caused this Supplemental Contract to be signed by its proper officers at Saint Louis, Missouri, this 25 day of February 1926.

J. DeWITT WILLS EDMUND P. NELSON
Secretary. President
Countersigned: Examined
Assistant Secretary.
(Seal)

CONTINENTAL LIFE INSURANCE COMPANY
ST. LOUIS, MISSOURI

Supplemental Contract attached to and forming a part of the Company's Policy No. 80480 on the life of John D. Bowman, the Insured. Face Amount of Policy $2,500.

MAJOR SURGICAL OPERATIONS AND DISMEMBERMENT BENEFITS

The Company will pay for major surgical operations an amount not exceeding Fifty Dollars for each $1,000 face amount hereof, provided the Company shall receive due proof that the Insured within the premium paying period, before default in the payment of any premium, prior to attaining age 60 and prior to becoming totally and permanently disabled has by reason of bodily injuries or disease contracted after the date hereof and after the payment of two full years' premiums on this policy, undergone a major surgical operation as herein defined which shall not result in death or total and permanent disability within ninety days from the date of such operation. The amount claimed by the Insured under the surgical operation benefit shall not exceed the actual cost of surgical and hospital fees. If the amount is less than the maximum benefit, the balance of that amount will be available to apply on future operations. Only such major

surgical operations as are performed in a hospital in the United States or Canada and which require complete and general anaesthesia, shall be regarded as within the meaning of this provision. Tonsillectomy shall not be considered a major surgical operation within the meaning of this provision.

The Company will pay benefits for dismemberments, subject to the conditions set forth below, in the amounts stated in the following schedule:

	Benefit for each $1000 face amount hereof
Loss of right arm above the elbow	$250.00
Loss of right arm below the elbow	150.00
Loss of left arm above the elbow	150.00
Loss of left arm below the elbow	100.00
Loss of either leg above the knee	250.00
Loss of either leg below the knee	125.00
Loss of entire sight of either eye	100.00

The foregoing benefits are payable provided the Company shall receive due proof that the Insured within the premium paying period, before default in the payment of any premium, prior to attaining age 60 and prior to becoming totally and permanently disabled has, by reason of bodily injury or disease contracted after the date hereof and after the payment of one full year's premium on this policy, sustained a loss as herein defined, which shall not result in death or total and permanent disability within ninety days from the date of such loss.

The surgical operations benefit shall not be available for any surgical or hospital fees incurred in connection with a claim for dismemberment for which a specified amount of benefit is herein provided. The Company shall be liable for payment of only one of the dismemberment benefits herein mentioned.

Major surgical operations and dismemberments benefits shall in no event be payable in excess of the amount applicable to a policy for $10,000, regardless of the number and amount of policies in force containing this benefit.

The annual premium for the major surgical operations and dismemberments benefits is $3.13 and is included in the premium stated in the consideration clause of the policy.

The provisions for major surgical operations and dismemberments benefits and the premium therefore may be discontinued at any time on written request of the Insured accompanied by the policy for endorsement. Any premium paid for any period not covered will be returned to the Insured.

IN WITNESS WHEREOF the Continental Life Insurance Company has caused this Supplemental Contract to be signed by its proper officers at Saint Louis, Missouri, this 25 day of February 1926.

P. Marks
Secretary.

E. J. Maus
President
Examined

Countersigned:
Assistant Secretary

(Seal)

To CONTINENTAL LIFE INSURANCE COMPANY, ST. LOUIS, MISSOURI

1. I, John D. Bowman hereby apply for a policy on my
(Write full name)
life for $2500.00 on the Bus. Policy and Life Plan,

(For Income Policies, state amount of income)
Non-Participating, Rate C with Double Indemnity
(A,B,C. or D)
for Accidental Death, with Major Surgical operations and dismemberments benefits, premiums payable ann annually first year ann annually thereafter.

2. I was born at Heber City, Ut. on the 25 day of December 1880. My age nearest birthday is 45 years.

3. My residence is (No.R.F.D. #3 Blackfoot
(Street or R.D.F. Town
(
(Bingham Idaho
(County State
(
(six miles in Northeast
(direction from Blackfoot
(
(Send premium
(notices to
(..
((Insert "Residence"
(or "Business")

4. I have resided at present address 4 years and for three years prior at Heber City, Utah
(City, State, Street and Number)

5. My place of Business is No. Blackfoot, Bingham, Idaho
Street City or Town County State

6. My occupation is Mgr. of my own farm & Leased farm.
(State exact duties in detail)

7. The name and address of my employer is Myself

8. Make policy payable to Bertha E. Bowman
(Write full name)
Relationship Wife
whose age is............(born on the......day of..................1............)
(Fillout for Continuous income Policies only)

9. I ......do...... make application for the Automatic Premium Loan Privilege.
(Insert the words "do not" if this privilege is not desired. The above statement is of no effect if application be for term insurance.)

10. I hereby request Please issue 2500 additional

(This space is for Special Requests, such as Preliminary Insurance, Issuance of Separate Policies, etc.)

11. The amount of insurance now in force on my life is, Life, $1000 Disability, $.........................., D. I., $.................... of which $...................... has been issued within the last three years by the following Companies......C.L.I.C.
12. I do not have any application pending in any other company except ....
(If there is not an application pending erase the word "except" but if an application is pending give name of company and amount.)
13. I have never been declined nor postponed for insurance, nor offered a policy different from that which I made application except..
(If there is not an exception erase the word "except" but if there is exception give name of company and amount)
14. My acceptance of any policy issued on this application will, without further notice, constitute a ratification by me of any correction in or addition to this application made by the Company in the space provided for "Home Office Endorsements Only."

FOR HOME OFFICE ENDORSEMENTS ONLY
Statement No. ....
corrected to read as follows;

15. I have paid to the agent taking this application, cash $87.58 being the first.............................annual premium on policy applied for.
16. I agree on behalf of myself and any person or persons, firm or corporation, who may have claim or any interest in any insurance issued on this application as follows:

(1) If the first premium is paid in cash at the time this application is made and this application is thereafter

approved by the Company for the amount, on the plan, and in accordance with the terms of this application, the insurance will be in force from the date of such approval; and the first policy year shall, unless otherwise requested, begin with the date of such approval. (2) If the first premium is not paid in cash at the time the application is made, or if a policy different from the one described in this application is issued, the insurance shall not take effect until the first premium thereon has actually been paid to and accepted by the Company, or its duly authorized agent and the policy delivered to and accepted by me during my life and good health; but in that event the policy shall bear the date of its issuance and all future premiums shall become due on such policy and all policy values shall be computed therefrom.

Dated at Bingham Blackfoot JOHN D. BOWMAN
(Signature of Applicant in full)
this 12 day of Feb. 1926
(Signature of Guardian if required)

J. H. WOOD H. A. JONES
Soliciting Agent Only Should Sign Here
(If two or more persons actually engaged in soliciting this application, the full name of each should appear hereon.)

General Agent J. H. WOOD
(If Applicant is a female, answer questions on back; if a minor, written consent of parent or guardian must be obtained. The agent's certificate on reverse side must be completed in all cases.)

No. 33853

CONTINENTAL LIFE INSURANCE COMPANY

APPLICATION, PART II — STATEMENT TO MEDICAL EXAMINER

THE APPLICANT MUST BE EXAMINED IN PRIVATE. THE EXAMINER MUST MAIL THE COMPLETED EXAMINATION TO CONTINENTAL LIFE INSURANCE COMPANY, ST. LOUIS, MO.

1. a. Full Name JOHN D. BOWMAN
   b. Age (last birthday) 45
   c. Race? White

2. Has any life insurance organization ever declined or failed to issue a policy on your life or offered one different than applied for? No Names of companies, dates and details? -----

3. a. What are your present occupations? (Explain exact duties)
   b. What were your former occupations? a. Farming
   c. Have you changed occupation or residence to improve your health? b. Same c. No
   d. Do you contemplate a change of either? d. No

4. a. Family Record		Age if Living	Health (Good or Bad) If not good, give full details	Age at Death	Cause of Death	How Long Ill	
Husband or Wife		43	Good				
Father				46	Accdl.		1
Mother				52	Pneum.	10 da	1
Brothers	(Living 3	55	Good	1 yr	not known		
	(Dead 3	42	Good	2 yr	not known		
		40	Good	47	not known	2 da	1
Sisters	(Living 2	47	Good				
	(Dead 0	38	Good				

b. Age attained by Father's Father? 75 Mother? Not Known Mother's Father? 65 Mother's Mother? 85

c. Have any of your family or relatives had tuberculosis or been insane? No

5. Have you ever had any disease or impairment of	Yes or No	Disease	Date	Duration	Results
a. Brain or nervous system?	No				
b. Heart?	No				
c. Lungs?	No				
d. Stomach, bowels, abdomen	Yes	Appendicitis	1905	8 days	Operated Good Recovery
e. Kidneys or bladder	No				
f. Eyes or ears?	No				
g. Any other disease or injury?	No				

6. a. Do you contemplate undergoing a surgical operation? — a. No

b. Have you ever raised or spat blood, — b. No.

c. Ever had syphilis? — c. No

d. Have you gained or lost weight in the past year. (State amount and cause) — d. No

e. Have you ever been on a restricted diet of any kind? — e. No

f. Has your urine ever contained sugar or albumen or casts? (Give details.) — f. No

g. Has your blood pressure ever been found to be above normal? — g. No

h. Have you ever applied for Government Compensation for War Disability? For what injuries? — h. No

7. a. To what extent if any do you use alcoholic drinks? (Give daily or other average.) — a. None

b. Have you ever taken treatment for any drug or liquor habit? — b. No

8. Are you now in good health? if not, state cause of ill health. — Yes

I certify the above answers are full, correct and true, and agree that all of the above shall constitute Part II of my application.

I expressly waive, on behalf of myself and of any person who shall have or claim any interest in any policy issued hereunder all provisions of law forbidding any physician or other person who has attended or examined me,

or who may hereafter attend or examine me, from disclosing any knowledge or information which he thereby acquired.

Dated at Blackfoot, State of Idaho, this 13 day of February 1926.
Witness:

W. W. BECK
M.D.

Signature(JOHN D. BOWMAN
of (To be written in prescence
Applicant(of Medical Examiner)

IV.

That the said original policy, supplemental contracts and application, of which the above is a copy, are in the possession of the defendant herein, having been delivered by the plaintiff to said defendant at its instance and request upon submission of proof of death of said insured, John D. Bowman.

V.

That on or about the 16th day of February, 1937, the said John D. Bowman died at Blackfoot, Bingham County, Idaho, before the allowance of any total or permanent disability benefits and prior to his attaining the age of 60 years; and that the death of the said John D. Bowman resulted directly and independently of all other causes from bodily injuries effected solely through external, violent and accidental means, to-wit: By the accidental discharge of a shot gun, which struck the person and body of the said John D. Bowman; and that the death of the said John D. Bowman occured within 90 days

from date of said accident and while said policy was in full force and effect.

VI.

That the plaintiff was the wife of said John D. Bowman at the time said policy was issued to him and so remained at the time of his said death and is the beneficiary named in said policy.

VII.

That up to the time of the death of the said John D. Bowman all premiums on said policy, including the premium for double indemnity benefits for accidental death as provided in said policy and supplemental contract, forming a part of said policy, were paid, and that in all other respects the said John D. Bowman duly performed all agreements and conditions of said policy on his part.

VIII.

That under and by virtue of the proceedings had in the Circuit Court of the City of St. Louis in the State of Missouri at the April term 1934, and proceedings had in said court subsequently thereto in the matter of R. Emmet O'Malley, Superintendent of the Insurance Department of the State of Missouri vs. Continental Life Insurance Company, a corporation, the said defendant, Kansas City Life Insurance Company, a corporation, took over under order of and by virtue of order of sale by the court the possession and title to all of the assets of the said Continental Life Insurance Company, including the policy of insurance hereinabove

mentioned and assumed liability on said policy of insurance; that in said court proceeding and by virtue of the power vested in the said plaintiff in said action, R. Emmet O'Malley, Superintendent of Insurance Department of the State of Missouri in charge of Continental Life Insurance Company, the said Superintendent of the Insurance Department of the State of Missouri, under order of the court, did sell and transfer to the plaintiff herein all of the assets of the said Continental Life Insurance Company, including the policy of insurance hereinabove referred to and by the terms of said sale and transfer of the assets of said company to the defendant herein the said defendant assumed the obligation of the said Continental Life Insurance Company and the obligations of said policy of insurance, and that said sale and assignment were duly ratified by decree of said court and which proceedings are duly recorded as instrument No. 189750 in Book 10 of Miscellaneous Records at page 195 of the records of Bannock County, Idaho, to which reference is hereby made for further particulars.

IX.

That after the death of the said John D. Bowman plaintiff furnished to the defendant due proof of the accidental death of said assured, and that the said defendant at the time it received said proof demanded of and received from the plaintiff said policy, which policy the defendant retains and still has in its possession.

X.

That no part of said sum has been paid by the defendant, although payment thereof has been demanded by this plaintiff, and that there is now due and owing from the defendant to the plaintiff upon said policy the sum of $5,000.00 with interest from the 16th day of February, 1937, at the rate of 6% per annum, together with costs of suit.

WHEREFORE, PLAINTIFF DEMANDS JUDGMENT against the defendant for the sum of $5,000.00, together with interest thereon at the rate of 6% per annum from the 16th day of February, 1937, and for costs of suit herein incurred.

Jones, Pomeroy & Jones,
Attorneys for the Plaintiff,
Residence and P. O. Address:
Pocatello, Idaho

(Duly verified)

(Title of Court and Cause)

ORDER OF REMOVAL

Filed in the State Court, December 2, 1937.

The defendant, Kansas City Life Insurance Company, a corporation, having filed its petition in due time and form for the removal of this cause to the District Court

of the United States for the District of Idaho, and having at the same time offered its bond in the sum of $500.00 with good and sufficient surety conditioned according to law;

NOW, THEREFORE, this court does hereby accept and approve said bond and accepts said petition and does order that this cause be removed for trial to the District Court of the United States for the District of Idaho, and the Clerk of this court is hereby directed to prepare and certify a transcript of the record herein to be entered in the said United States District Court, and that no further proceedings be had herein in this case in this court.

Done in open court this 2nd day of December, 1937.

J. L. DOWNING,
Judge.

IN THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF IDAHO, EASTERN DIVISION,

---

BERTHA E. BOWMAN,

Plaintiff,

vs.

KANSAS CITY LIFE INSURANCE COMPANY, A Corporation,

Defendant.

No. 1032

ANSWER

Filed February 25, 1938.

For answer to plaintiff's complaint defendant:

I.

Admits paragraph I of said complaint.

II.

Admits paragraph II of said complaint.

III.

Admits paragraph III of said complaint.

IV.

Admits paragraph IV of said complaint.

V.

Denies all of the allegations of paragraph V of said complaint except that defendant admits that on or about the 16th day of February, 1937, the said John D. Bowman died at Blackfoot, Bingham County, Idaho, before the allowance of any total or permanent disability benefits and prior to his attaining the age of 60 years and admits that the said policy was in full force and effect at the time of plaintiff's death;

Further answering said paragraph V of plaintiff's complaint defendant alleges that said insurance policy referred to in plaintiff's complaint provides among other things that double indemnity benefit shall not be payable if the Insured's death shall result directly or indirectly, wholly or partly from suicide, and defendant alleges that Insured's death resulted from suicide.

IX.

Denies each and every allegation of paragraph IX of said complaint except that it admits that defendant retains and still has in its possession the policy therein referred to.

X.

Denies each and every allegation of paragraph X of said complaint except that it admits that no part of said sum alleged as due and owing has been paid, and alleges that there is nothing due and owing from the defendant to the plaintiff upon said policy except the sum of $2,500.00 which said sum was before the commencement of this action tendered by defendant to plaintiff, same being the full amount to which plaintiff was entitled, which said sum defendant, coincident with the filing of this answer deposits in court for the plaintiff.

WHEREFORE, Defendant prays that plaintiff take nothing in excess of judgment for the amount tendered into court and here offers to allow judgment to take judgment against it for said amount, to-wit, $2,500.00, and that defendant have its costs.

Dan B. Shields,
Residence: Salt Lake City, Utah.
F. M. Bistline,
Residence: Pocatello, Idaho.
Attorneys for Defendant.

(Duly verified)

(Service accepted February 23, 1938)

(Title of Court and Cause)

MINUTES OF THE COURT OF MARCH 25, 1938

This cause came on for trial before the Court and jury, Jones, Pomeroy & Jones, Esquires, appearing for the plaintiff, and F. M. Bistline and Dan B. Shields, Esquires, appearing as counsel for the defendant.

The Clerk, under directions of the Court, proceeded to draw from the jury box the names of twelve persons, one at a time, written on separate slips of paper to secure a jury. G. M. Parish, whose name was so drawn was excused for cause; S. R. Rostad, Ronald Lundstrom and Frank Siddoway, whose names were likewise drawn were excused on the plaintiff's peremptory challenge and Floyd Bradbury, J. P. Sorensen and Wm. P. Camp, Jr., whose names were also drawn, were excused on the defendant's peremptory challenge.

Following are the names of the persons whose names were drawn from the jury box, who were sworn and examined on voir dire, found duly qualified, and who were

sworn to well and truly try said cause and a true verdict render, to-wit:

Ronald Clark	Wilkie Noble
Chas. Briggs	Thomas H. Barnes
Hugo L. Clark	J. H. Sommercorn
R. C. Pettingill	Charles Shumway
Hugo Elg	Ronald H. Miller
A. B. Brough	James Peterson

After a statement of the plaintiff's case by her counsel, Verna A. Bowman, Bert Bowman, Rose L. Barris, Melvin Bowman, Brigham Harrocks, John N. Barnard, John C. Sanberg, E. C. Peck, Byron Jackman, J. D. Gibbs, L. C. Adams and Bertha E. Bowman were sworn and examined as witnesses and other evidence was introduced on the part of the plaintiff.

After admonishing the jury, the Court excused them to ten o'clock A. M. on March 26th, 1938, and continued the trial to that time.

(Title of Court and Cause)

MINUTES OF THE COURT OF MARCH 26, 1938

The trial of this cause was resumed before the Court and jury. Counsel for the respective parties being present, it was agreed that the members of the jury were all present.

Dr. H. E. Miller was sworn and examined and Melvin

Bowman was recalled and further examined as witnesses on the part of the plaintiff, and here the plaintiff rests.

Counsel for the defendant moved the Court for a judgment of non suit upon the question of double indemnity. The motion was submitted without argument and was by the Court denied. The defendant asked and was granted exceptions.

The defendant's counsel made a statement of the defense to the jury, whereupon Howard Packham, Ira Corey and Dr. A. N. Newton were sworn and examined as witnesses and other evidence was introduced on the part of the defendant and here both sides close.

The defendant's counsel renewed the motion for a judgment of non-suit upon the question of double indemnity. The motion was denied by the Court. The defendant asked and was granted exceptions to the order.

The cause was argued before the jury by counsel for the respective parties, after which the Court instructed the jury, and placed them in charge of a bailiff duly sworn, and they retired to consider of their verdict.

On the same day the jury returned into court, counsel for the respective parties being present, the jury presented their written verdict, which was in the words following:

(Title of Court and Cause)

VERDICT

"We, the Jury in the above entitled cause, find for

the plaintiff and assess her damages against the defendant in the sum of $5,000.00.

Chas. Briggs,
Foreman."

The verdict was recorded in the presence of the jury and then read to them, and they each confirmed the same.

(Title of Court and Cause)

VERDICT

Filed March 26, 1938.

We, the Jury in the above entitled cause, find for the plaintiff and assess her damages against the defendant in the sum of $5,000.00.

CHAS. BRIGGS,
Foreman.

(Title of Court and Cause)

JUDGMENT

Filed March 26, 1938.

This action came on regularly for trial, said parties appearing by their attorneys. A jury of twelve persons was regularly empaneled and sworn to try said action and witnesses on the part of the plaintiff and defendant were sworn and examined. After hearing evidence,

the argument of counsel and instructions of the Court, the jury retired to consider of their verdict, and subsequently returned into court, and being called, answered to their names and presented their written verdict, as follows:

(Title of Court and Cause)

Verdict

"We, the Jury in the above entitled cause find for the plaintiff and assess her damages against the defendant in the sum of $5,000.00.

Chas. Briggs,
Foreman."

WHEREFORE, By virtue of the law, and by reason of the premises aforesaid, it is ordered and adjudged that said plaintiff have and recover from said defendant the sum of Five Thousand Dollars ($5,000.00), with interest thereon from the date hereof until paid, together with said plaintiff's costs and disbursements incurred in this action, amounting to the sum of $144.20.

WITNESS The Honorable Charles C. Cavanah, Judge of said court, and the seal thereof this 26th day of March, 1938.

(SEAL) W. D. McREYNOLDS.
Clerk.

(Title of Court and Cause)

MINUTES OF THE COURT OF JUNE 15, 1938

The defendant's motion for a new trial was presented to the Court and argued by F. M. Bistline, Esquire, on the part of the defendant and by T. D. Jones, Esquire, on the part of the plaintiff. At the conclusion of the argument, the Court announced his conclusions and ordered that the motion for a new trial be, and the same hereby is denied. The defendant asked and was granted exceptions to the order.

(Title of Court and Cause)

BILL OF EXCEPTIONS.

Lodged August 13, 1938.
Filed August 29, 1938.

Be it remembered that the above entitled cause come on for trial on March 25, 1938, being one of the days of the March Term of said Court, before C. C. Cavanah, Judge of said court, and a jury duly impaneled. Jones, Pomeroy & Jones, Pocatello, Idaho, attorneys for plaintiff; and Dan B. Shields, Salt Lake City, and F. M. Bistline, Pocatello, Idaho, attorneys for defendant.

A jury first having been empaneled and sworn according to law and counsel for plaintiff having made their opening statement, the following testimony of wit-

nesses was offered by the plaintiff to maintain her complaint.

VERNA A. BOWMAN, a witness called on behalf of plaintiff being first duly sworn, testified as follows:

DIRECT EXAMINATION BY MR. JONES:

My name is Verna Bowman. I live in the house back of the sugar factory at Blackfoot. I was living there on the date John D. Bowman met his death. This house is about 200 or 250 feet from the barn where Mr. John Bowman met his death. It is north or northwest from the barn. There was a chicken coop about 150 feet from the barn between my house and the barn,—maybe 100 feet from my house to the chicken coop and 150 feet from the chicken coop to the barn. My husband made some measurements by stepping it off. I didn't make any measurements myself. I have been living there about one year. Prior to and at the time of John D. Bowman's death there were birds all over the place. There was a granary by our place and there were holes in the granary where the birds could get in.

I know where the door is that leads into the barn where Mr. Bowman was found dead. It is on the north side of the barn. I saw Mr. Bowman the first time on the date of his death when he was helping one of the boys load hay. The second time I saw him was when he came to my house for the gun about one-thirty and got the gun. He worked the mechanism of it, I guess you would call it. I said there is no shells and he picked up the gun and

walked out. I followed him to the door, and as he opened the door the birds flew out of the tree and he said "birds." He appeared as he always did. He came to the house and asked me for something. I thought he wanted his pipe wrench. He talked to the children and tapped or touched them on the heads. His appearance was cheerful. He smiled all the time. As he left with the gun, he said "birds" and motioned to the birds which were flying around from the trees, with the gun. I didn't notice where he went.

I next saw him that day about 3:30 going toward the barn. He wasn't far from the barn when I saw him, but I can't say how far it was. I went into the coop and raked up the straw, and while I was taking that straw out I heard a shot about five minutes from the time I saw him going towards the barn. I didn't think anything about the shot at the time. I noticed the birds there, there were so many flying around in all directions. Nothing else attracted my attention. I went on changing the straw out and putting fresh straw in there, and then I went to the house and I picked up some sewing that I had been doing before I went to the chicken coop and started sewing and I heard another shot. It was about twenty minutes later, between the first and second shot. These shots came from the direction of the barn.

CROSS EXAMINATION BY MR. SHIELDS:

Mr. Bowman had been ill for about a year before that. He had had a stroke at the beginning of the illness, but he was recovering. He had recovered all but his speech.

He did not walk with a limp; his right arm was affected; it was getting better though, but on cold days he would drop things. The day he came to me, I could not make out in the first place what he wanted. I first offered the wrench which we had borrowed but he said "No." The gun was in plain sight. He got it himself. He was at my house about a half hour. He visited with and talked with the kids, and I didn't pay any attention to what he said to them.

There are two houses to the north of the barn. I live in the south house. The other house is farther north. The barn is about 60 feet by 30 feet wide. The long way is east and west and the wide way is north and south and it is two story. The barn is to the south and east of my house, and the chicken coop is diagonally to the south between the barn and my house.

When Mr. Bowman went away from my house he carried this gun. I never noticed whether he had the gun or not when he came back. I was in the chicken coop when I saw him in the barn lot at the barn.

RE-DIRECT EXAMINATION BY MR. JONES:

There is no obstruction between the chicken coop and the barn to prevent a person from seeing from one place to the other. When I heard the shots, I never thought anything about it. I never heard of Bowan's death until the evening of the same day.

BERTRAM N. BOWMAN, a witness on behalf of plaintiff being first duly sworn, testified as follows:

DIRECT EXAMINATION BY MR. JONES:

My name is Bertram N. Bowman. I live just west of the sugar factory. I am a son of John D. Bowman. The house where I live sets diagonally northwest of the barn about 250 feet, and the chicken coop is about 100 feet from the house, in between the house and the barn on a little of an angle.

I first saw my father on the day he died with my brother with a team and wagon back of the house about 10 or 10:30 in the morning. He got on the wagon and rode to the barn with me. I had a conversation with him at that time. He appeared just the same at that time as he had for days before. His physical condition appeared perfect; he could do practically anything that the rest of us could do.

I next saw him about one-thirty or two-thirty o'clock in the afternoon just inside the barnyard gate between my house and the barn taking the gun toward his house. Within the week prior to the time that I saw him with the gun, he would help us with the chores, and the day before he had helped us to repair a sleigh tongue, and did numerous jobs around the barnyard. He would do most everything there. In the summer of 1936 he went out with me and did some irrigating, and before that he showed me cuts to take out. He supervised all of the irrigation. He drove the derrick team and milked some of the cows. He told me less than two weeks before the accident that he would be on the farm helping us this summer and show us more how to farm.

As to his family relationship with my mother, I never knew of them to have a cross word. His right side was affected by the stroke. The condition of his right arm was different from the rest. In cold weather when he would pick things up in his right hand, he would sometimes drop them because his grip wasn't as good with the right hand. I have seen him around the cows. He would often run the cows in and he would quite often have a part of them all milked when we would come in. He had been able to milk cows the latter half of the summer preceeding his death, but when it was cold he couldn't grip the cow's teats. I saw him possibly twice a day, and practically every day from the time of the stroke up to the time of his death. It was between two and three months after sustaining the stroke that I noticed he was beginning to improve. I observed that his recovery was slow. At first his leg was a little lame, and his arm wasn't nearly as strong, but his feeling and the use of his leg came back, and it came into use more each day, and continued to get better every day up to the day of the accident.

There was an awful lot of birds around our barn, and also around the feed lot adjoining the barn. And you could never go into the loft of the barn without scaring a lot of birds out. The barn is a frame structure about 28 by 46 feet. It has a gable roof and tie arms across the rafters. It is about ten feet from the hay loft floor to the tie-arm. The barn has two windows in the west and two in the east. There is a large hay door between the east two. Those windows were between two and a

half and three feet square, and they are about four and a half feet from the floor of the loft of the barn. The windows had no glass in them. There was a canvas that was tacked down diagonally across the window which came down diagonally from the north side. There was about one-third of the window that was not covered. There were birds in the loft of this barn. There were always birds and lots of them. There were lots of birds all over at the time my father met his death; they were in the hay loft and around the granary,—lots of them. They were sparrows.

The oat granary is back of the barn on the west side,—down below this southwest window with a lean-to roof to the south, and the doors to this granary have never been very tight. You can never go in there but what a lot of birds will fly out of there. We also have a wheat granary where we stored the seed wheat, and the birds could get in there some, but not so much.

I recognize what has been marked as plaintiff's exhibit No. 1 as the gun. There has been a slight change in it since I saw it. The stock has been repaired; it was repaired by Roswell Barris; and also the gun is cleaned up a great deal since it was at my house.

My father was around five foot six in height and of stocky build. My youngest brother is about the same build and size.

CROSS EXAMINATION BY MR. SHIELDS:

I am the husband of Mrs. Verna Bowman who testified The gun had been at my house three or four days.

I had it on the feed lot shooting sparrows out there. I think I had it over there at the house altogether between six weeks and two months. It had not been in the possession of my father for something like five or six months before that time. I hardly think there are as many sparrows out there now as there were last winter. My father did not have a paralytic stroke; it was thrombosis. It occurred December 1, 1935.

He was prostrate in bed for six weeks, after which he slowly got well, but was somewhat lame to begin with. He had a halt in his right leg, and his right hand was numb, and at first he could not use that hand as well. There was no time after he had this illness when he actually could use this hand as well as before this sickness, and he always had to a certain extent favored that hand. He had some difficulty with his speech; articulating was difficult for him, and that was true up to the day that he died with some words, but other words he could say all right. The words he pronounced from the point of his tongue, or short sharp words, he said well, and I saw no marked difference in these words. At the time he died, he was about the same weight as he was before his illness, having regained his normal weight.

It is a twelve-gauge gun.

The gun had some repairs to it. The stock was another stock and did not have this shoulder bolt on it. It is the same gun, and has been considerably cleaned up. The trigger is just the same as it was. I will explain where the alterations were made in the gun stock. This

piece (indicating) that was off, and we had no shoulder bolt, and it was more or less a little rough in here (indicating). This piece on here in the gun (indicating) you will notice had been spliced in. We found this gun when we were coming over the Lincoln Creek Divide. A hunter had lost it, and someone had run over it and broken this off, and we put this piece in here (indicating). The tape that is around here (indicating) was on here at all times during the last year. The tape to which we are referring is immediately under the Clerk's mark. The upper part of the stock is repaired, and the lower one-half is the original.

I was not with my father every day. The contact that I had with him was just accidental meetings or occasionally, or when I went over to see my parents. I would see him about the place as I would drive back and forth; sometimes I would get through around 11:20 at noon, and he would be around the barn and I would help him take care of the chores and things. On account of my employment I am compelled to say that the contact between me and my father was not as close as it had been when I was growing up, but I was there to dinner about a month or so prior to the accident and stayed there from 11:30 to 1:00, o'clock. On the day of the accident I saw him carrying a gun through the gate into the barn yard at about 1:30 or 2:00 o'clock in the afternoon. He was headed toward the house. He was walking toward the east or toward the south. At that time I was going with a load of beet pulp to the scales to weigh it. The

scales were south between the barn and dad's house and he had to walk by there. I did not pay any attention to how father was carrying the gun. I was about twenty or thirty feet from him at that time.

Father would help with the chores. We had from twelve to sixteen horses in the corral, four cows, a couple of calves that had to be fed and watered twice a day, and the cows put in the barn and milked. On the day in question there was no hay in this loft of the barn and had not been for sometime prior thereto. To do the chores would involve putting hay in the stalls. Part of the winter it would have required somebody going up in the loft. We put a little of the third crop of hay in the hay-mow and fed the cows when we kept them in during the cold nights. I don't remember what time the last of the hay was put in there; it could have been a month, and it could have been a month and a half. I never took care of feeding the cows, but would help milk. Birds can come in and go out of the windows in the loft of the barn.

REDIRECT EXAMINATION BY MR. JONES:

My father used another gun from the latter part of November up to the time of his death there on the premises. He used a gun to kill a stray dog soon after the first of December in the yard there. He took one shot at this dog, which was about fifty or sixty feet away. The gun was a twenty-two single shot.

He sometimes got into the loft of the barn to feed hay to the stock. When we were harvesting the beets, he used to feed the horses practically every night for us.

ROSWELL H. BARRIS, a witness on behalf of the plaintiff, being first duly sworn, testified as follows:

DIRECT EXAMINATION BY MR. JONES:

My name is Roswell H. Barris. I then lived at Groveland three miles north and west of Blackfoot in Bingham County, Idaho for over thirty years. I am not in any way related to the Bowmans. I know that Exhibit No. 1 is a twelve-gauge Winchester repeating shot gun. I bought this gun at an auction sale at the Boyle Hardware Company on February 26, 1938, and reconditioned it. I took it apart and cleaned the works and reconditioned the stock. The works of the gun were all gummed up with hard grease, and it was corroded until I had a lot of difficulty in cleaning it out. I had to use soap and water and a brush, to clean the grease and grit from the works of the gun.

CROSS EXAMINATION BY MR. SHIELDS:

I am now the owner of this gun. I know nothing about the gun before. I had never seen it before the sale.

MELVIN BOWMAN, witness on behalf of plaintiff, having been first duly sworn, testified as follows:

DIRECT EXAMINATION BY MR. JONES:

My name is Melvin Bowman. I live at Riverside five miles out of Blackfoot. I am the son of John D. Bowman, deceased. I know my father sustained an illness in December, 1935, and I saw him nearly every day until this winter, and then maybe it would be two or three days. At first he was in bad shape; he was bad off, and then he

seemed to improve a lot and get out and around. At the time of his death his physical condition was pretty near normal, all but his speech and one arm. That was the only thing very noticeable at all. In cold weather his arm would get more numb and he would not have use of it that he would on days that were warmer.

I saw him the day before his death hitching up some colts to break them, and we broke the sleigh tongue out and we fixed it. By "we" I mean him and my brother and me. He would get the tools and help, just like any of us. I think the first thing he did was to start to heard the cows after he got out of bed. He took them to the pasture, and then he would supervise the irrigating, and in the second and third crop of hay he drove the derrick team for about two hundred tons of hay. I saw him do other things also. He helped with the threshing, and in the fall he helped by feeding the cows and the horses and repairing the machinery. He would drive a 1937 Plymouth car around the farm. He drove it practically all summer. He was greatly improved and seemed to be better in the fall of 1936 than he was in the summer. I never saw him milk, but I saw him there; I did the chores on my own place. I knew he fed the cows. I had a talk with him shortly before his death, in the spring when we were breaking the colts, as to his future plans. He told me he would help me run the place this coming summer.

The last time I saw him was about three o'clock in the afternoon on the day before the accident. A few days

before his death, I was fixing a beet drill and I changed it from a twenty to twenty-two inch row, and he knew the difference. I could tell from his appearance whether he was despondent, or cheerful, or happy, or how he was; he appeared to be happy, just like normal. I don't remember that he ever said anything to me about his condition. He was never pressed for finances because they were all right.

I am about five foot six tall. Compared with the height of my father, I don't think there was a fraction of an inch difference in the two of us, and my build was practically the same as his. I will stand up and take Exhibit No. 1. His arms were about the same length as mine.

I saw that gun in the barn lying diagonally across him in the southwest corner of the loft. There was a perpendicular ladder that went up on the north side of the barn to reach the loft.

It was around a quarter to five on that same day, in the afternoon, that I first learned of my father's death. I went to the place where he was found after I had been up to the undertaker's and sheriff's office. I went up to see the sheriff and undertaker. I found my father in the southwest corner of the barn; his feet were about one and a half feet from the wall, lying in a southeasterly direction. His feet were about one and a half feet from the west wall and a little north, about four inches, of the southwest window. His body was about one and a half feet from the wall and just three or four inches north

of the window, that is, the north portion of the window, and the gun was lying horizontally across the left leg with the butt toward his feet. I made no close inspection of my father.

Later that evening I looked around with the others for evidence of shot in the barn loft at the same time the sheriff was there or about five o'clock. I discovered where the shot had taken effect; it was two feet from the west wall and ten feet from the floor of the loft to a two by four it hit in the wall, just a little southeast from his feet; it was just over his feet and back just a little. It was just two feet from the west wall, nearly perpendicular. I didn't look closely at the point where the shot was embedded, but there was flesh and little shreds of clothing, and they were scattered about the floor of the loft. I noticed one empty shell lying on his right side, and an empty shell in the gun. I made some examination to see whether any other shots had taken effect in the barn and found no shot except the one I have described. Where the body lay, I found a two by six board around three feet long; it had not been moved because the print where it was lying was still just the same.

PLAINTIFF'S EXHIBIT NO. 1 (shotgun) was offered in evidence at this time and admitted without objection.

CROSS EXAMINATION BY MR. BISTLINE:

I heard of my father's death just as I got into Blackfoot about five o'clock. I went out to the barn. I think the sheriff, coroner and I went into the barn together.

We went in the outside door of the barn. I don't remember who went up the ladder into the loft first. I was there when the body was moved. My father was lying on his back with the gun across his body diagonally across his left leg with the butt of the gun resting between his feet. The muzzle of the gun was up along his side, the gun being on top of him or across his body. The shot had hit the ceiling by the two by four in the ceiling and his feet in reference to the position of the shot were just a little west, about six inches west, almost directly under and a little to the north. He was under the first rafter, beginning from the west; it would be the first rafter two feet from the end. I don't remember whether there was any shot in the cross member that comes across the rafter, but there were a few scattered shot in the top of the sheeting upon which the shingles are fastened. I noticed parts of his clothing, just threads, up close in there where the shot had taken effect. I noticed this myself. I looked around at other boards in the roof but found only the spot where one shot had taken effect. I did not notice closely, but I remember flesh on the roof of the barn. It was in the top and looked to be in the supports. There was also flesh on the floor. I don't remember where my father's arms were as he lay there. It is too long ago, and I guess I didn't take very close notice of that. I didn't look very closely at the condition of his face, but I have a pretty plain picture of it. I noticed his chin. The shot had hit him in the left side of the face, but I don't remember whether his chin

was still discernible. I do not recall the condition of his mouth as I only saw him this once, nor do I recall the condition of the left ear. I never examined his left shoulder. I only looked at him generally and didn't make any minute examination.

I am almost of the same height as my father; there is but a fraction of an inch difference, and I am of the same dimensions generally.

Witness Melvin Bowman stepped down from the witness box in front of the jury and the stock or butt of the gun was placed on the floor by his feet with gun in a nearly perpendicular position to the floor against his body with the muzzle or end of the barrel pointing upward alongside his left breast and in this position was requested to reach the trigger with his finger. But the witness was unable to reach the trigger with his finger while the gun was in this position without bending his body. With the gun in the same position he then bent over and reached the trigger with his finger and in so doing the muzzle or end of the barrel extended above the top of the left shoulder of the witness.

REDIRECT EXAMINATION BY MR. JONES:

I know that these shoes that have been marked plaintiff's Exhibit No. 2 are the shoes my father was wearing at the time of the accident. I think they are in the same condition now as they were at that time. They have not been used.

PLAINTIFF'S EXHIBIT NO. 2 received in evidence.

This winter we had quite a little snow before the accident, and there had been a lot of sparrows there. These granaries were open so that they could go in and out, and we were feeding a little wheat which was quite a treat for the sparrows. There was no hay on the floor of the barn at the point where father was found lying after the accident, but there were a few lucern leaves on the floor.

BRIGHAM HORROCKS, a witness on behalf of the plaintiff, being first duly sworn, testified as follows:

DIRECT EXAMINATION BY MR. JONES:

My name is Brigham Horrocks. I lived at Blackfoot since 1919. I was acquainted with John D. Bowman, having known him as long as I can remember, both being born in Heber, Utah. I have been in the merchandising business at Blackfoot since 1924, new and second hand furniture, and other kinds of things, operating under the name of Clegg Furniture Company. Mr. Bowman worked in the same store about a month before in the winter.

I recall the day the accident occurred. I saw Mr. Bowman at the store on that date at about 2:30 in the afternoon. He got two shot gun shells at that time. He had gotten shells there before. He would come in in the winter time and buy not more than 25c worth of shells at a time, and very often he would get two, three or four

shells. The price on shells was five cents per shell. When he got the shells he said he was going to shoot birds.

I knew he had a stroke. I went to his home many times when he was sick. After he had the stroke, for the first few months I was there every day and sometimes twice, and as he improved I didn't call so often, but I saw him two or three times a week. I could see a very marked improvement as time went on. At the time of the accident, he seemed to favor his right hand, and other than that his physical condition was good. He would show us he was getting better. His speech had an impediment. It was not too plain; I could understand lots of his words but not all of them. At times he could be understood better; he would say three or four words without any trouble at all, and at other times he would only say one or two words.

I think he left the store that day about 2:30 in the afternoon. He seemed to be the same to me as he did for days. He was alright and gaining all the time and was happy about it. He would always say "Hello" and "How are you" when he met you, and whenever you went to his house to see him, he was tickled to see you, and when you left he would always say to come again or don't go now, or something like that. His family relationship was very good.

CROSS EXAMINATION BY MR. SHIELDS:

He bought two twelve-gauge shotgun shells from me. I did not wait on him as he helped himself. He did not pay for them on that day. It was his habit to buy shot-

gun shells in two and three and never more that a quarters worth; this was over a period of five years, longer than that. The time he bought a quarter's worth of shells before this day, I cannot say, but it would be in 1934, making an interval of at least two years that he didn't buy any shells. These were the only shells that he bought from me during the period from the time that he was taken up with his sickness to the present time. This time he came in and helped himself. He was familiar with the store. I walked up to where he was and wrapped up a package I had that another fellow had bought, and he showed me that he had two shells. I said to him, "You don't want them. Leave them here." I said that to him in a kind of a kidding way, and he said "I am going to shoot birds," and he walked out as I wrapped up the package for this other fellow. As I remember it, it is every detail. I do not remember any conversation about telling him I didn't know what he was taking away.

I did not see the body of the deceased after the accident until it was in the casket and prepared for burial.

REDIRECT EXAMINATION BY MR. JONES.

It was his custom to come in and if we were not ready to wait on him, he would wait on himself. As he started to leave with the shells, I said "Jack, you don't want them. Leave them here." I always kidded with him and he did with me. There is nothing unusual in this; he told me he was shooting birds, and I knew it was his custom, so I dismissed it from my mind entirely.

JOHN N. BARNARD, a witness on behalf of plaintiff, being first duly sworn, testified as follows:

DIRECT EXAMINATION BY MR. JONES:

My name is John N. Barnard. I have lived at Blackfoot approximately thirty years. I am a sugar factory employee. I work as a mechanic outside, and when they operate I am foreman. I was at the sugar factory on the day that John D. Bowman met his death. I quit work at 4:00 that day and went into the shop which is separate from the factory. I went to the Bowman barn about 4:20 that afternoon to get my horse and lead him out to water, and when I got him outside in the light I noticed there was blood on his side. There was no puncture in the skin. On tracing its source, I found it had leaked through the floor of the hay loft, and I went up and found Mr. Bowman lying on his back in the southwest corner just under the window. I did not examine the body at that time. I then notified one of the boys and told him that his father had met with an accident and he said we better get brother Bert and the other brothers who are in town and we then notified Bert. I did not notify any officer until after I found the boys in town, and they went to the sheriff's office. I didn't go back with the boys and the officers.

When I went back the sheriff and the coroner were there, two of the Bowman boys, and I think another gentleman was there too. I observed what they were doing. I went up into the loft. The body was in the same position and condition when I got there with the coroner as

it was when it was when I saw it first. I noticed that the gun lay across the body in a kind of diagonal position, with the butt of the gun toward his feet and the muzzle toward his head. It was not lying in a perpendicular position, that is, perpendicular with the body, but it was more across, and the muzzle pointing toward the left. His feet were about a foot and a half from the wall, a trifle north of the north side of the window. There was one shell to the right of the body. There were no other shells on the floor, but the sheriff extracted one from the gun. Both shells were empty. I noticed that one shot had taken effect in the roof of the barn about two feet from the west wall and about ten feet from the floor. It was directly over the window. It was back kind of. The shot in the roof was more horizontal than perpendicular from where his feet were. I observed threads of a denim coat, and blood and particles of flesh at the point where the shot had taken effect in the roof. I believe his cap was laid just to the side there. There was a piece of two by six, lying on the left side of the body, and it looked like it had never been disturbed from the dust and leaves that were around there. I observed nothing else, no contrivance of any kind. So far as I could see no other shot took effect in the barn. The height of the window from where the body was lying was about four and a half feet from the floor. There was a canvas kind of dropped down about half-way across the window. There was nothing to obstruct a load of shot being fired through the window.

Mr. Bowman was dressed in khaki pants and a blue denim jumper. He had shoes with rubbers on over the shoes. He was dead the first time I saw him as far as I could tell. The shot looked as if it had struck the left side of his coat and gone into his chin and took the left side of his face off.

CROSS EXAMINATION BY MR. SHIELDS:

I did not examine the face of the dead man closely as he lay there. I took no notes. I did not notice the jumper that he had on very carefully. I don't know as I said there was a hole in the jumper, but part of the lapel was shot away, I do remember that. I didn't pay a whole lot of attention to that jumper for I was just a little bit excited. I cannot tell whether there was one or two holes in the jumper. My best judgment is that there was some of the lapel gone, because there were some of the threads in the roof.

When we went back to the loft of the barn, so far as we could tell the body had not been moved from the time we left until we came back. And the gun was in the same position with the barrel, or muzzle of the gun pointing at the man's head, or in that direction, and the butt was on the ground, or near his feet, and his body lay in a slanting direction not square with the building or lengthwise. I think it laid more toward the north and the gun lay across the body, and the barrel of the gun, the muzzle pointed toward the left side of his head and was still lying on his chest. I don't remember the position of his hands. I did not examine the gun, but I did see this dis-

charged shell lying to the north of the prone body, and while I was there the sheriff extracted the second discharged shell from the gun.

I am not able to give a very definite description of the dead man's face. The statement which I made with respect to this shot having gone in under the chin is the way it looked to me. I cannot say for sure that part of the chin was still there. I was not accustomed to a sight of this kind, and I didn't pay very much attention to it; the things I have spoken of are the things that forcibly struck me. I was the first one to find the body and under the circumstances I have related. I did not see the body after it was taken to the undertaking parlor. The search I made for the shot was just a casual examination. The place where the shot went into the roof was three or four feet over my head. I did not climb up to it. Whatever judgment I have was obtained from the floor, from looking at it from the floor of the loft. There was no light there. It was fairly light in the barn at that time. When the sheriff and undertaker got back, it was about five o'clock. That was on February 16. The window was not quite half covered with canvas, dropping away from the top, and I believe the cover dropped about half way at the bottom, and it kind of feathered, so to speak, away toward the south.

JOHN C. SANDBERG, witness on behalf of plaintiff, being first duly sworn, testified as follows:

DIRECT EXAMINATION BY MR. JONES:

My name is John C. Sandberg. I live at Blackfoot,

am coroner of Bingham County, Idaho, was such on the 16th day of February, 1937, was called officially that day about five o'clock, or possibly a few minutes after. I went to the sheriff's office and to the sugar factory barn. The sheriff, Mr. Barnard, and one or two of the sons of Mr. Bowman went with me. When we got to the loft of the barn we found the body of Mr. Bowman in the southwest corner near the window. I made no measurements of the window. We found the deceased near the window, his head to the southeast, not quite in line with the barn. We found a gun lying across his body near the feet; the butt was near his feet but not quite in line with the body; it was diagonal toward the left side. We also found that Mr. Bowman had been shot in the left side of the face. The sheriff found an empty shell to the right of the body, and then he extracted another empty shell from the gun. I did not discover any contrivance of any kind that could be used there at all. There were some hay leaves on the floor, and I believe a plank, a two by six, back near the window. When the sheriff lifted the plank, it showed an imprint or impression on the leaves, indicating that it probably was there for some considerable time. We examined the roof above the deceased, and in the rafter we found shot with particles of flesh and threads of clothing. That evening we made an examination to determine whether there was any other shot that took effect in the hay loft. It was beginning to get a little dark, and the following morning the coroner's jury was summoned

and the jury with myself and the sheriff made a thorough investigation of the hay loft. We found no other shot except the one I just testified to in the roof above the deceased. The jury returned a verdict and I signed the standard death certificate of the state as coroner. Mr. Peck of the Brown-Eldridge Mortuary took the body out of the barn. As near as I could determine, the left side of his face was pretty well shot away, indicating to me that the shot had probably been under the left side of the chin where the shot first went in. He was dressed in a jumper, and a sweater that was under the jumper, a shirt, and the usual underwear. There was a hole on the left side of the denim jumper near the shoulder, and a larger hole near the top of the shoulder on the left side.

CROSS EXAMINATION BY MR. SHIELDS:

I made the usual preliminary examination to see if the cause of death could be determined. The examination made at the barn was somewhat superficial, without definitely diagnosing any cause of death.

When I went to the mortuary, I found that the evidence of injury was to the left side of the face, and as near as I can describe it, that side had been shot away. If I recall, the chin was there. I don't know whether the entire chin was there or whether the shot extended down to the left side to include the chin, but it was down the left side quite a distance. I don't hardly think the flesh was all there on the left side underneath the chin. The undertaking work had not all been done when I got there a second time, but they were doing some of it, and they

were preparing the body for that work. Part of the chin and the jaw bone on the left side had been shattered, and the left side extending to the eye was pretty well torn away. I don't recall how much of the flesh on the left side under the chin had been knocked away from there. I don't recall whether the sweater underneath this jumper had a hole in, or not, but there was some markings the same as the jumper. I am not sure whether they were just the same, or if they had been torn away, or what, but it would seem that the shot was through the jumper, but I don't recall whether that sweater was intact, or not, but the jumper had a small hole in the shoulder, in that piece of material that goes across there, and then there was a larger hole near the top. I am not sure whether the larger hole was closer or farther away from the collar, but as I recall, it was about half way. Exhibit No. 3 is the same jumper of which I have been speaking. The smaller hole is closer to the collar than the larger one I observe from this exhibit. He wore this jumper at the time I saw him lying there.

E. T. PECK, a witness on behalf of plaintiff being first duly sworn, testified as follows:

DIRECT EXAMINATION BY MR. JONES:

My name is E. T. Peck. I live at Blackfoot, am a funeral director and also in the furniture business, being so engaged a number of years. I went to the barn of Mr. John D. Bowman on February 16, 1937. I do not recall who accompanied me. I think the sheriff, the coroner, a Mr. Barnard, and some of the Bowman boys were

there when I went into the loft of the barn. I did not make any particular examination at that time. Several men were standing in the west end of the barn, and I could see the body lying there. It was near the window of the west end of the barn with the head lying toward the north and the feet toward the south. The left side of the face was badly shattered and there was a gun lying over the body. I think they were examining the shells that lay on the floor near the body. I do not know whether any other shells were ejected from the gun while I was there. I took no part in the examination of the loft to determine where, if any place, shot had taken effect, but they were making an examination. After this examination, with the assistance of the sheriff and somebody else, we put this body into the receiving case and I took it to the east end of the barn and let it down through the doors to the car and took it to the mortuary. I saw the jumper the deceased had on at that time, but I made no particular examination except to say that it had a hole in the left shoulder. The wound on the deceased's face, according to the best description I can give was the entire length of the left side of the face from the chin clear up past the eye.

I was at the undertaking parlor when they took the clothes off and put the body on the table, being there when the coroner came. I cannot say that I made any closer inspection of the face, because I had my opinion formed as to where the wound was. I saw the wound again, and it confirmed my former opinion. The coroner

was there and wanted to see the body before it was touched by us.

CROSS EXAMINATION BY MR. SHIELDS:

Most of the left side of the face was gone. There were flaps of flesh at the left of the eye hanging down, but I don't remember as to the flaps of flesh from the chin. I cannot positively answer as to the mouth, what its condition was. The left eye was out of its socket. I can't answer as to the left ear. There was no reason for me to make any particular detailed examination or inspection of the body. I have an embalmer there who takes care of that work. I don't do very much of that actual work any more, and he did that work on this body. When the body was prepared to be put in the casket, I saw that it was properly done, and that is the last attention I paid to it, except of course, taking care of the funeral.

REDIRECT EXAMINATION BY MR. JONES:

I think I said that the left side of the face was mostly destroyed, and that would be true with reference to the left side of the chin. I didn't embalm this body. The party who did embalm the body was not a certified embalmer; he was an apprentice.

BYRON JACKMAN, a witness on behalf of plaintiff, being first duly sworn, testified as follows:

DIRECT EXAMINATION BY MR. JONES:

My name is Byron Jackman. Since 1911 I have lived seven miles north of Blackfoot. I am not related to the Bowman family in any way. On the day Mr. Bowman

lost his life, I arrived at the sugar factory around three-thirty o'clock. I heard a shot just as I turned into the barnyard gate. I know where John D. Bowman's barn was. It was about 150 to 200 feet from the barn when I heard this shot. Later I heard another shot. It was about 15 or 20 minutes between the two shots. I heard the first shot around three-thirty or twenty-five minutes to four.

I have been up in the loft of the barn before as I kept my team in the barn. As evidence of life in the barn there was a large number of birds that would fly out of the window as I went up to the loft. I did not hear of Mr. Bowman's death on that day. I had occasion to examine the loft the next morning. I can't say who all was there, but I know that Sheriff Corey and one or two of the Bowman boys were there. I went around with Mr. Corey. The only thing I ever saw there was where one shot had hit the top of the barn up near the window. There was some blood there and some particles of flesh and clothing that was in the top of the barn at the point where the shot was embedded in the wood. We went over the barn from one end to the other on the floor looking for other shots. It was light enough to see the top of the barn too, but I could not find anything.

NO CROSS EXAMINATION

J. D. GIBBS, a witness on behalf of plaintiff, being first duly sworn, testified as follows:

DIRECT EXAMINATION BY MR. JONES:

My name is J. D. Gibbs. I have lived at Blackfoot

for 30 years. I knew John D. Bowman about ten years. I first learned of his death on February 16 between four and five o'clock. The body was still there when I went to the place where it was found. At the time the sheriff, the coroner, Mr. Peck, and one of the Bowman boys and some others were there. When we went in the body was lying in the west part of the barn, and there was a gun lying across the body, and the left portion of the face was shot away. There was a piece of two by four that didn't look as though it had ever been moved and there were hay leaves all over the floor, and some parts of his clothing and flesh was in the rafter and roof of the barn. About the clothing there was flesh and blood. There was shot in the ceiling right over the window and back to the north, right over the body. I did not make any examination to ascertain if any other shot had taken effect in there. The cloth in the roof was pieces of blue denim jumper, part of the jumper that Mr. Bowman had on when I saw him. His head was lying in a southeasterly direction with reference to his body. Some of the shot had cut through his jumper on the left side.

NO CROSS EXAMINATION.

L. P. ADAMS, a witness on behalf of the plaintiff, being first duly sworn, testified as follows:

DIRECT EXAMINATION BY MR. JONES:

My name is L. P. Adams, of Riverside, about five miles west of Blackfoot. I have lived in this section since 1886. Farming has been my occupation most of the time,

but in the last years I have followed road construction for contractors. I knew Mr. Bowman.

I went to the barn as a member of the coroner's jury about the middle of the next afternoon. It was quite light in the barn. We went with the coroner and the sheriff, and they explained to us where the body was lying and they showed us where the shot was that they had found in the rafter of the barn. There were two windows in the west and two in the east of the barn, and this was the south window of the two in the west. This shot was right to the side and part of the shot was in the rafter, the first rafter from the west end of the barn, about a few inches north of the line of the north side of the window. This was the southmost window in the barn, and I observed that there was particles of flesh and blood where the shot took effect in the barn, and also particles of the blue denim jumper at that place. The entire jury, including myself, stayed better than an hour and looked closely all over the barn. There were five other jurymen besides myself, and the sheriff and coroner. We could not find any other shot, but this shot showed quite plain, like it was fresh marked on a board rather shortly after it is done. I don't think the undertaker had done a great deal to the wound on his face because the jury went to the undertaker's before we went to the barn. The left side of his face was practically shot away. As near as I can recall, the wound started on the left side of the center of the chin, but I do not recall exactly where it would be.

CROSS EXAMINATION BY MR. SHIELDS:

I didn't pay any particular attention to the condition of the deceased's mouth at the undertaking parlor, but I recall that there was some skin kind of laid back just above one ear and close to the eye. It was just laid back. I do not remember some skin lying back on his neck nor his ear being torn away nor the eye being out of the socket. If I paid very much attention, I do not recall it now. I haven't thought any more about it since that time, but I remember it was quite a bad looking sight. I knew the left side of his face was pretty well gone. The wound began right about the center, probably off center a little, of his chin and clear up to his eye; I would not be sure whether the chin was all left or not. From the eye up was left fairly good as I remember it now. I don't recall that there was any flesh down underneath the jaw. As to the mouth, it seems to me like there was a little of the skin still visible there. I am pretty sure the nose was partially visible. He didn't have clothes on when I saw him but was on the cooling board at the mortuary, covered with a sheet. On his shoulder there was a mark extending from about the left nipple upward to his shoulder. It veered just a trifle toward the shoulder. The direction was probably closer to the center where it started and probably veered a little bit. It has been quite a while and I could be mistaken about this. The only information I had about this was that which came to me in the course of my official capacity as a member of the coroner's jury that was viewing the scene of the alleged ac-

cident and the remains. I had known Mr. Bowman for about 15 years and knew of the illness which had overtaken him in the latter part of his life. I saw him frequently after that, although I would say sometimes it was quite a spell in between times. After he began convalescing I saw him at times; the summer after he was sick I was away quite a lot, but that following fall and winter I saw him quite often. In the latter part of the season I saw him two or three weeks apart, and later in the year I saw him more often. I have talked with him and I noticed the impediment in his speech. At times I had some difficulty in understanding him. Sometimes when he would talk he could say two or three words, and then maybe some word would bother him and he would have to finish the sentence more by motion; and other times he could the words right plain. I noticed the last time I was with him for any length of time that his right hand was a little awkward.

REDIRECT EXAMINATION BY MR. JONES:

I knew Mr. Bowman very well. I saw him after the harvesting season of 1936, having a long talk with him in November. Of course, I might be off on those dates. I went to the house and nobody was home, so I went down to this shed where he keeps his machinery and I think he was repairing some double-trees. I just walked up and slapped him on the back and he whirled around and took hold of my hand. At that time he looked good and acted quite good. Of course, I cannot remember anything particularly that he said outside of I do remember

of asking him about some third crop hay that was there, and I asked him what he was feeding that to and he said to the cows. He was very cheerful in his action; he was always cheerful when I saw him. I don't think it would be over a week before the accident that I last saw him for I generally saw him when I went to Blackfoot.

The mark on his shoulder was kind of a black mark running up there.

BERTHA E. BOWMAN, plaintiff, being first duly sworn, testified as follows on her own behalf:

DIRECT EXAMINATION BY MR. JONES:

I am Bertha E. Bowman, the widow of John D. Bowman; we had been married about 35½ years and had lived in Idaho about 22 years, either in Riverside or Blackfoot. We moved to Blackfoot four years ago, in January, 1934. I have one son in college, and at the time of the accident my husband and I lived alone. He always was very kind to both me and his family and he was of a happy and cheerful disposition. He had always been kind to me from the time I married him. His financial condition was good; he never did go in debt. He was not in debt at that time. He sustained or suffered an illness some fourteen or fifteen months before he met his death, or about the first of December, 1935. He was very ill for a few weeks in bed. His right side was paralyzed, but he began to improve and as time went on the improvement was continual until the time of his death. He was confined in bed about six on seven weeks. After he got out of bed, he continued to improve up until the day of

his death. At the time of his death his physical condition was perfect with the exception of his speech and his right hand. He couldn't grasp things like he did before his sickness, and at times he dropped objects, and especially the dishes when he was wiping them for me.

He told the boys in my presence that he would show them how to farm, speaking of his future plans, and stated to me that he wanted to help them with the crops in the spring of 1937, and that as soon as our son was out of school in June we would take a trip to California to visit our daughter.

Mr. Bowman had a custom or practice of shooting birds, while we were living on the farm. We lived at Riverside until 1934, after which we moved to the place where he died. He shot birds the first winter that we were there, the winter of 1934. His stroke was on December 1, 1935. After his stroke he spent his evenings and his time listening to the radio and reading the papers, and I always talked to him and we read together. We read many chapters each night. We went to shows and entertainments, and in the fall we went to political rallies. He went down town and back whenever he wished. He always went down on Wednesday and Saturday mornings to my son's barber shop. If he wished to go down he walked down and back at other times. He nearly always walked. It is a little less than a mile from our home to Blackfoot's center of town. He talked about his physical condition. I cannot mention any dates, but we often talked about it, but I can't say the time and place,

but it was evening on many different times, and also in the day time he would tell me that he was better, and he went through a lot of movements to show that his arm was better, movements to show how strong and better it was, for it had been so weak.

We had two guns in the house after his stroke, one a twenty-two and the shotgun on display here. The twenty-two was always in the house and there were shells there for it. The shotgun was not always in the house because we loaned it, and it was with other members of the family part of the time, and then it would be brought back and put in the same place in the clothes closet that it always was. It was in and out. The shotgun was in our house during the summer that Mr. Bowman was recovering from his illness.

There were times when I left Mr. Bowman at home alone for a considerable period of time; I went every week to Relief Society meetings and then I went to Utah in the fall and was gone for three days and no one stayed with him at that time. I can't give the date I went, but I returned the evening of Thanksgiving; that was the November before he died. I was gone nearly three days and two nights. As to shells around the house, there were twenty-two shells at all times, but we never kept any shot gun shells at any time.

The day of his death he got up and made the fires, and we had our breakfast together, and then he went down to the barnyard to help haul some hay, and he came in at noon and ate a hearty dinner and helped me to clear

up the table, and wiped the dishes. I went to my meeting and he went out toward the barn, and that is the last I saw him. Before he came in at noon, he was at the barn-yard helping the boys. After this stroke he did many littil things around the place to help me. He milked the cows and did a lot of chores around the place. He chopped kindling, shoveled snow and made paths for me to hang my clothes out,—I can't mention all the things that he did for us. He always helped with the dishes; if he was in the home at all he would help so that we could be together. He could read but not very long at a time before his eyes were weak from this stroke but he could read. I didn't observe him when he first started milking the cows, but I have seen him later on. I cannot give the positive dates that the shotgun was in our house during the six months period before the date of Mr. Bowman's death, but I know that it had been in our home and where it always had been kept. My son would not know about that. He could not know it was not there. It could come and go without his knowledge. Our son had the gun for a continued period of time for six weeks, or two months, and then the other son had it at his house for some period of 60 days at one stretch before Mr. Bowman came over for it. I am almost positive the gun was in our house during the month of January, 1936. I cannot tell when it was taken away the first time after January, nor when the boys borrowed it. It was in the closet and if the boys wanted it they came and got it. I do not know for sure that it was away for six weeks im-

mediately prior to the date that Mr. Bowman used it on the 16th day of February and I know that they were shooting birds at the feed yard about every day.

CROSS EXAMINATION BY MR. SHIELDS:

After my husband's death someone purporting to represent the Insurance Company brought me papers to fill out about the particulars of my husband's death, which I filled out and signed.

MR. SHIELDS: I am not going to make any point of the fact that proof was not filed. Whereupon it was stipulated between counsel that plaintiff in this action made and furnished and delivered to the defendant proof of the accidental death of John D. Bowman and all proof that was required under the policy for double indemnity under the accident death clause of the policy and that no question is raised by the defendant as to that matter, nor will be raised during the progress of the trial or at any time, and it is admitted by the defendant that this stipulation extends to and goes to the making of claim by the plaintiff for double indemnity under the accidental death clause of the policy, but defendant does not admit that John D. Bowman came to his death by accidental means.

WITNESS RESUMING: Mr. Bowman's recovery from this illness was slow at first, but it seemed so gradual that we could see the improvement continually. Until the time of his death he had a rather pronounced speech impediment and had marked difficulty with his hand, especially in cold weather. It would become numb

and the circulation was bad in cold weather, and I would have to run him. I thought it was the circulation that was bad. I don't know whether the stroke impaired his eye-sight so much as his eyes have been weak for quite a few years.

DR. A. E. MILLER, witness on behalf of the plaintiff, being first duly sworn, testified as follows:

DIRECT EXAMINATION BY MR. JONES:

I am Dr. A. E. Miller of Blackfoot, a surgeon and physician by profession. I have lived in Blackfoot since January, 1934, a little over four years. I knew John D. Bowman during his lifetime, and I had occasion to see the body at the undertaking parlor while it was there after his death; it was the day after his death. I graduated from the University of Oregon Medical School at Portland, Oregon, served my interneship at the Los Angeles County Hospital, and am now licensed as a practicing physician and surgeon in the state of Idaho.

At the time I examined the body of John D. Bowman at the undertaking parlor the day following his death, I found there was some friction marks, or what you might call an abrasion approximately from the nipple, that is, starting at the nipple and terminating at the collar bone along the left side, and then on his face there was—I might say the undertaker had done some repairing on the face, but there was a place approximately near the outer third of the jaw bone on the left side where there had been some repairing on the jaw, and on the inside

middle there was quite a bit of repairing, and quite a good deal on the outer side that he had repaired, that is, his plastic work was done, and there was some softening on the skull on the left side. From the examination I made, it was my impression that the load had possibly split out the jaw bone from going in from out here (indicating). The left eye was dropping out, sort of a dropping of the socket a little. The cause of that was possibly a destruction of the muscle of the cheek bone which was depressed. I didn't feel it, but it gave the impression that it was depressed. It was in the area of the external wound on the left side of the face, in the same place.

CROSS EXAMINATION BY MR. SHIELDS:

My examination was not merely perfunctory for the purpose of signing a death certificate. I signed the death certificate with this reservation: I made a notation of what the coroner's jury had agreed on as the cause of death. I didn't examine the body with the intention of making a certificate of the cause of death or for the purpose of being a witness or anything like that. I looked into the mouth. The mouth was partially drooping open. I didn't feel around there, but there had been some repair work done that I could see. I was there during the time of the examination about 10 or 15 minutes.

A thrombosis is the clotting of blood in a vessel, and a cerebral thrombosis is a clot on the brain which produces an action akin to paralysis. It does produce paralysis, depending of course on the amount of damage to the brain tissue and depending of course on the pressure,

or the edema. Of course, when brain cells are destroyed, they do not regenerate, but as I say, depending on the pressure, it might clear up. Depending upon its location, it might also cause instant death.

REDIRECT EXAMINATION BY MR. JONES:

I observed Mr. Bowman during his lifetime to determine if he was recovering from the illness which he had received in December, and he was recovering nicely. He came in for a check-up fore this time, and was doing nicely.

RECROSS EXAMINATION BY MR. SHIELDS:

In the thrombosis, that is, if there is an actual destruction of the brain tissue or the nerve cells, they never regenerate, if the brain cells are actually destroyed; but if the paralysis is through edema, they will gradually come back as the pressure is released.

REDIRECT EXAMINATION BY MR. JONES:

The extent to which the area is destroyed would depend largely upon which the result of the recovery is, and if there is a good recovery, it is demonstrated, of course, that there was not much destroyed. There was a good recovery in this case.

RECROSS EXAMINATION BY MR. SHIELDS:

His mind was alert but he could not coordinate his speech. He knew, of course, what he wanted to say, but his speech remained hampered as a result of this thrombosis that he had the prior year.

PLAINTIFF RESTS.

MR. SHIELDS: Comes now the defendant, the Kansas City Life Insurance Company, a corporation, and the defendant in this action, and makes a motion for a non-suit upon the ground that the plaintiff has not established accidental death in the case in question here. The defendant believes that the obligation and the burden of establishing death in this particular action by reason of accidental, violent and external cause is upon the plaintiff, and we believe that they have failed to establish this in that manner. They have established the death, but we feel that the proof is entirely lacking as to the accidental feature, in connection with this case, and for that reason, and upon that ground, we asked the Court for an order of non-suit at this time.

THE COURT: And do you want to be heard upon this motion?

MR. SHIELDS: I am willing to submit it.

MR. JONES: Certainly.

THE COURT: Then it, the motion, will be denied.

MR. SHIELDS: May we have an exception?

THE COURT: You may have your exception.

HOWARD PACKHAM, witness on behalf of the defendant, having been first duly sworn, testified as follows:

DIRECT EXAMINATION BY MR. SHIELDS:

I am Howard Packham of Blackfoot, Idaho, age 25. I have lived there about a year and a half this last time; I had lived there before. I was living in Blackfoot on the 16th of February, 1937, being employed there as an

embalmer for the Brown-Eldredge Mortuary. I was not registered as I was an apprentice embalmer at that time. I was working in connection with preparation of bodies for burial then, and on that date I had occasion to see the body of John Bowman. I first saw it in a receiving case when it was opened in our establishment after being brought into the Mortuary. I made an examination of the body, coming in contact with it at that time. I worked on the body. As I remember, the body was brought to our establishment by Mr. Peck, my employer, and that was the first time I saw it. The clothing was removed with the assistance of other people, I don't remember who. He was dressed with shoes and ordinary socks, trousers and an ordinary gray work shirt, a blue jumper of some kind, and other than that I don't remember much about the clothing. The body was placed on the preparation table. I immediately set about washing away any blood that had accumulated so as to get down to the flesh and set about repairing his damaged features. As soon as I had gotten the blood and the loose matter washed away, I set about embalming the body with an injection of embalming fluid which takes about several hours to accomplish embalming. After this was done, I began the reconstruction of the features of the face. The first thing I remember is that the left eye was completely out of the socket, the left eye ball that is. It was lying on what we call the temporal region of the left side. The left ear was split from the lobe up about halfway in the ear, and there seemed to be about three distinct rents or

tears in the flesh of the left cheek. It seemed to be in more of a fanlike shape; the smaller part was down here (indicating) and they were extending in a fan-like shape over this side, over to the upper part of the head and down here (indicating) to the point of the jaw. The palate seemed to be in about five different pieces, more or less, but there were about five distinct sections or broken pieces of the palate. A section of the right jaw bone protruded through the skin, breaking through the skin on the right side about three inches between the point of the chin and the right ear, about half way from the right point of the chin to the right ear. I felt the head of the deceased with my hand; it felt loose to the touch and was not solid. I was not able to tell distinctly where his mouth had been or was. I tried to reconstruct the mouth from a comparative measurement of the other anatomy of the face, and did so. On the region of the left shoulder there seemed to be a slight scratch of some type, about two inches in length. No other mark was there, and there was no other mark or wound on the right side except the protruding jaw bone on the face. As to bruises or discolorations other than those described, I am afraid I cannot be very definite about bruises or broken flesh around this wound on the face. The broke tissue was red. Of course, in the process of embalming, through the lack of tissue off from the broken tissue, the latter assumes a rather burned appearance, which is the action of the formaldehyde on the broken flesh or tissues. The roof of the mouth was in about five different pieces,

still seeming to be connected together by some connecting tissue. They were not wholly destroyed, there being enough that I could distinguish that it was the roof of the mouth. There was blood and matter of some sort oozing through these breaks, but it would be hard for me to tell what it would be. On the left side under the chin and neck as I remember, was a tear about three inches long, extending somewhere on the left side sort of diagonally down toward the side of the neck, from this point here (indicating) on down. The flesh was still there at the place where this tear was, going down on both under part of the chin on both sides, but not very much of the chin was left on the left side; hardly any of it was left. By fan-like tears, I mean that they get larger towards the extremities and are smaller at the base. Practically all of the left side of the face was gone. It seemed as though those tears could not be reconstructed definitely into their original shape, but only to a point about midway of the cheek. They seemed to be extending out to here (indicating the breaks on the flesh.)

I removed the jumper among the clothes, with the assistance of Mr. Peck. That is the jumper and is in the same condition at it was when it was removed from the body of the man. I don't recall whether he had a sweater or suit of underclothes. Exhibit No. 3 is the jumper I removed from Mr. Bowman.

EXHIBIT No. 3 admitted in evidence.

IRA COREY, witness on behalf of the defendant, being first duly sworn, testified as follows:

DIRECT EXAMINATION BY MR. BISTLINE

My name is Ira Corey. On February 16, 1937, I was sheriff of Bingham County, serving in such capacity for four years. At the present time I am a state traffic officer, having held that post since August 7, 1937. I saw the body of John D. Bowman in the southwest corner of the hay loft of the barn back of the sugar factory at Blackfoot about five o'clock in the evening along with Coroner Sandberg, Jack Gibbs, two sons of Mr. Bowman and John Barnard. We went into the hayloft, no one ahead of me, but Mr. Sandberg, the coroner, Gibbs and Barnard and the two sons all going in, following one another up the ladder, which was made of a one by four nailed on a siding on the north wall of the barn, a little to the east of the center of the north side. This was the only entrance to the loft I noticed. I saw the body lying in the west end of the hayloft and proceeded to make an examination as to who it was and the conditions surrounding. Mr. Sandberg and I made an examination and the rest of them stood back and said or did nothing. We looked to examine the wound on the face, the position of the gun, the position in which the body was lying relative to the location of the barn walls, and then I removed the gun from the body, just reaching down and picking it up. It was lying with the butt of the gun between the feet of the deceased, kind of lying between his legs, more by his left arm, kind of diagonally across his body. The muzzle of the gun was just a little to the left of the position of the heart of the body. His left hand

was lying down to the side of him. When I picked up the gun, I noticed that it had blood stains on it, and an empty shell in the barrel. A little piece of flesh was in the muzzle and fell out when I tipped the gun up. I extracted the shell which had been discharged. The trigger hammer was down pressing the firing pin against the shell. I extracted the shell and looked around for other shells, finding one empty shell lying to the right side of the body. These two were all the shells we were able to find. I took the gun into my possession, took it to the sheriff's office where we made a further examination that same evening. We found that it was workable, that is, whether it would extract the shells from the gun and whether the hammer would fall on the firing pin and cause the shell to explode; in general, to see whether the gun was in condition to shoot or not. The trigger pressure was just average. We examined the gun to see if it could be discharged without pulling the trigger; we raised the hammer and dropped the gun on the floor a distance of one foot with a sudden jar to see if the jar would set the gun off, but the test failed to cause the gun to go off or fire. We made probably a dozen such tests.

At the loft we examined the surroundings. The hay mow was empty with the exception of a few alfalfa leaves on the floor of the barn there. The floor was entirely covered with leaves. The ceiling was bare and we found a little at the left and over the body where a charge of shot had entered the roof. At this point was a little piece of denim pinned to the roof where a shot

had held it there; there was some small particles of flesh and blood with stains there, and from there north for a distance of probably six feet were pieces of flesh up in the roof, and some particles on the cross bar or the binder from one side of the building to the other. There were pieces of flesh on that. At the window in the west part of the barn, just above the seat of the body, were small particles of flesh and bloody spots on the sill. The window in the west part of the barn was about three feet square and about five feet from the base of the window to the floor. There were particles of flesh on the edge of a 2 x 4 or a 2 x 6 at the bottom of the window, which protruded into the barn. I don't remember about any glass in the window, but there was some canvas there on the window to the south of that one. This was about eighteen inches to the wall, north of Mr. Bowman's body, and then it was about five feet above him. His feet were in front of that window, at the bottom of the window, but the body laid away. The window closest to him was the one with particles of flesh on. His body was in the southwest corner of the barn.

The left side of his face was practically gone, and no mouth was there. I didn't notice the right jaw bone, but the left eye was not in the proper position. It was lying over with the flesh, apparently partly out of the eye socket. He was lying directly on the back of his head. His lower plate was broken into pieces in several places and lying with the mangled part of his face, and the upper plate was out and lying along the side of the

face. Neither plate was in his mouth, the upper plate being to the left of his face, lying along with the torn part of his face. His teeth were where his face was torn and strung out. I made no observation as to the teeth in the plates. Either the coroner or myself picked up the plates, but the coroner took possession of them and turned them over to Mr. Peck. the undertaker. There was not much blood on the floor, but the part of the face that was injured was bloody. I couldn't tell one part of the face from another very easily because of the blood being commingled with the flesh and torn parts of the face. His left ear was practically covered with a piece or pieces of flesh lying back over it, flapped back over his ear.

The first time I was in the barn, I stayed possibly three-quarters of an hour. Outside the time one of the other people went out to phone for the undertaker, the entire group of us remained there during that time. The undertaker came about thirty minutes after we arrived, put the body in a carrying case and took it down either the ladder or the north side. It was just starting to get dark when we left there. It was still daylight during this time so we didn't need or use any artificial light to make our examination.

I went back to the barn on the following morning, February 17, with the county coroner, the deputy sheriff, and the younger Bowman boy, the short and heavy set one, about 9:30 in the morning. We examined the interior of the barn closely to see where there could be another discharge of shot, and also examined the location of the

particles of the flesh and shot in the ceiling above the body. We didn't get up to where the shot was, examining it from the floor, which is about ten feet below the marks above. These marks were made where the shots entered the roof and the rafters. The shot was in the rafter and in the sheeting with shot holes sprinkled all around either side of the rafter. The greater part of the shot was on the west side of the rafter. I don't remember seeing any shot holes in the shingles at that time. We made an examination to determine at what angle the shot entered the sheeting and rafter; they had apparently come from the direction or angle where the body was lying. There was nothing I hadn't seen the day before. The piece of blue denim, pinned to rafter by a shot forcing a raveling into the wood, had fallen to the floor. It was about an inch in diameter, the size of a twenty-five cent piece. We picked it up and looked at it, but didn't keep it. I don't know what became of it. I noticed, as I had the night before, the flesh in the rafter, the greater portion of which was a little north, and that there was but little flesh where the shot was. I examined the flesh again, being better able to see than I had the evening before. It was exactly the same as it was on the previous evening; small particles of flesh up to the top; on this cross bar there was also little pieces of flesh that had dried and stuck fast there. It was sort of a mattery, gooey, sticky particles that had been blown into real fine pieces, sort of a pink or whitish color. Being on the cross bar, it was about eight feet above the floor and about four feet

above the point where the other flesh would be. The highest marking of flesh was nearly at the gable. No one moved the flesh then or any subsequent time, while I was there.

Mr. Bowman had on a denim jacket; underneath that I do not know what he was wearing. The jacket had a hole in it and we found a scar on the top of the left shoulder. It was a dark streak across the top of the shoulder, about three quarters of an inch wide and about two and one-half inches long. It appeared as if a hot iron had been laid on there. I saw the body at the undertakers later, after the embalmer had entirely completed his work. When I first observed the body the chin was about half gone, but beneath the chin it was nearly normal. There were no tears immediately under his chin, but there were tears to the left of the chin about here (indicating). The whole side was lain open as if it had been cut with a clever. These were the only two occasions that I was at the barn where Mr. Bowman died.

I had known Mr. Bowman about six years and knew his physical condition. I saw him on occasion since his illness in 1935, having seen him as I was driving by his place to the sugar factory in discharge of my duty. As to conversing with him, I only remember passing the time of day. I don't know that he ever spoke, but he waived his hand. I have seen him walking and noticed nothing out of the ordinary. I recall seeing him in the corral, no particular date, but probably some time when I was out serving papers in that section. I probably saw

him two or three times under such circumstances. I did not ever see him up town in Blackfoot after his illness.

CROSS EXAMINATION BY MR. JONES:

I examined the barn thoroughly after the accident but could find no other place where any other shot other than the one above his body had taken effect. No contrivance was found near the body. We found a piece of two by four on the floor which a person could tell had not been moved since the alfalfa leaves had been put there. As to the position of the shot in the rafter in relation to the body, I don't recall which rafter it was from the window in the west end. The area of the place was about ten inches where the shot was in the roof. I testified at the coroner's inquest and there said "they were in a circle of about five inches in diameter," but to my best recollection, it was ten inches. There was one empty shell on the floor and another in the gun which I extracted, both of which had been recently fired, also I could not tell by the gun for it was cold, it having been some time since it was fired. They were new shells. We found only where one shot had been fired, but whether it was the first or second we did not know. I thought the window was three feet square, but I didn't measure it, nor did I measure the distance from the bottom of the window to the floor. It could have been less than five feet. I noticed the jumper and the fact that the left side of his face was shot off. I said at the coroner's inquest, in response to a question about the two shots, that "The shot that went through his face would have to go through the hole in

his jumper before it hit his face." If it hit his face, it would have to go through his jumper.

Where I discovered the biggest portion of the flesh was a little bit north, about four feet north from the point where the shot had taken effect. There was some blood and flesh on the lower sill of the window. His feet were about eighteen inches from the west wall, which would make the shot somewhat perpendicular, veering a trifle off to the south from where his feet were lying. The only thing I found around the body was a piece of two by four which was three or four feet long with some alfalfa leaves on it and had the appearance of not having been moved. The scar on the left shoulder had the appearance of a burn and was in close proximity of where the face had been shattered by the shot. I could not say on which window the canvas was. The body was at the southwest corner of the hayloft, but at this time it appears to me that it was on the north, but of course it could have been different, I guess. The lower plate of the artificial teeth was broken. I don't know whether the upper plate was in good condition or part of the teeth gone, but it wasn't broken, but was lying out of his mouth to the side of his face. It was light enough to make an examination when we got there and started to get dark just as we left. I didn't intend to say that half of the chin was gone, nor nearly gone, but part of it was gone, with more gone on the left side.

REDIRECT EXAMINATION BY MR. BISTLINE:

I didn't make any measurement of the shot pattern on

the roof of the barn, but merely was giving my estimate when I once said five inches and another time said ten inches. This estimate was made as I stood on the floor of the hayloft. Some of the shot showed as far over on the sheeting as five, six or seven inches. A few stray shots were on the east side of the rafter; they would be four or five inches over as they hit while on the diagonal direction and just missed the rafter. The shot pattern was about ten inches in diameter in my best judgment. The piece of denim on the rafter was just mixed up with the shot, just stuff plastered up there. I did not find any flesh on the denim. There was less flesh near the denim than in other places, that, over further, further north. More flesh was on the window there than where the shot marks were. The piece of two by four was south and east of the body, a little above his head to the north, directly over his head as he lay on the floor. He was lying on the floor with his head to the southeast, making the board southeast of his head. The floor just south of where the deceased lay was a rough board floor. The place to put the hay down was open, and he was just north of that, right close. This piece of two by four was close too. I moved it, noticing the hay leaves as did the others. I mentioned it to the county coroner and we determined that it had not been used for any purpose as the leaves had not been disturbed. I didn't make any particular examination around the point where his feet rested. Neither the coroner nor I made any examination in that regard. I did not discover any footmarks or any dis-

turbance on the floor at that end of the barn. No one, in my presence, went up to the gable of the roof where the flesh was to look for shot holes. We made no measurements with tape or rule; all figures are only my estimates. I don't know what the condition of the teeth on the plates was. There was some teeth on the plate, but I don't know how many. The upper was in a whole piece. I am not certain whether the coroner or I picked the teeth up but I think he did. The undertaker may have picked them up when he moved the body.

When I saw the body at the undertaker's parlor, I noticed that scar on his shoulder was just a dark reddish streak. When I said it was three-quarters of an inch wide, I merely made an estimate for I had not measured it. When I was testifying at the coroner's inquest and said that the shot would have to go through his jumper to hit his face, I did not mean that it actually went through his jumper and hit his face.

DR. A. M. NEWTON, witness on behalf of the defendant, being first duly sworn, testified as follows:

DIRECT EXAMINATION BY MR. SHIELDS:

I am Dr. A. M. Newton of Pocatello. I have been a general surgeon for 25 years at Pocatello. I graduated from Northwestern and did clinical work afterward.

Thrombosis is a condition within a blood vessel in which the blood forms a clot and is adherent to the lining of the vessel. A cerebral thrombosis would be the same thing in a vessel of the brain, as in any other vessel of the body. There is little difference in the vessels

of the brain. Of course, there is a difference if it is in an artery other than in some vessel of collateral circulation in the surface. Complete recovery or restoration of original health in a case of cerebral thrombosis depends upon the damage done to the brain tissue.

In a case like the present, where a person suffered thrombosis which produced an illness requiring inactivity making him bedridden for approximately six weeks to two months; and which, when he got up, caused difficulty in walking, difficulty with his right arm which became numb in cold weather so as to cause him to drop things, and which caused a partial impediment of speech, so that at times he could speak clearly and at times not, the duration of which was from December 1, 1935, to February, 1937; and from which he recovered slowly, but continued to improve so that he was apparently quite well at the time of his death except for a speech impediment and numbness in his right hand during cold weather; but an illness from which he continued to get better after leaving his bed, that he recovered from and again began to be interested in things, because of pleasant disposition, began to work around the house and in the yard once to the extent of fixing a tongue in a sleigh; and which left him with a weak right arm causing him to drop things, such as dishes when he was helping his wife, and making him unable to grasp things firmly with his right hand, and which left with an impaired speech so as to make it difficult for people to understand; and yet from which he recovered sufficiently to go to town at least twice

a week and do chores, milking the cows occasionally. I think such illness was probably an involvement of a moderate degree. As to recovery, there is, of course, practically no regeneration of nerve tissues after eighteen months following a nerve injury. Any improvement after that would be in my mind, muscle education. In case of involvement of the nerves after a period of eighteen months, any improvement would be from, as I say, muscle education which comes in the use, for instance, if it is the hands or extremities, in the use of the hands and extremities and the educating and building up of those muscles by use.

I have had experience with gunshot wounds. I served in the base hospital in France during the World War, and I have also seen quite a few of them in civilian practice. I was in France one year, in the hospital practically all of the time. My work dealt exclusively, almost, with treatment of gunshot wounds. I had occasion to see people who had been injured externally from high explosives, such as TNT and bomb explosions. I saw about every kind of gunshot wound and high explosive wound, and every injury of most every kind and every kind of wound that was known at that from every kind of explosive that was in use in the war. And in my practice at home I have seen gunshot wounds, both rifle, revolver and shotgun: I think only one case of a gunshot wound in the face, but rifle and revolver wounds in the head and about the body generally.

If a man had come to his death as a result of a gunshot

wound and I found, upon examining the body, that beginning with the lower jaw bone on the right side midway between the point of the chin and the end of the jaw bone, the jaw bone was fractured and protruded through the cheek, while on the left side the jaw bone was completely shattered to the extent that very little bone was left which could be used in rebuilding the contours of the chin; that on the left side of the face the cheek was shattered and the flesh lay back in about three distinct flaps, open and lying back upon the neck; that one of these tears extended from the left corner of what appeared to have been the mouth to the lower lobe of the ear with several flaps equally long running in fan-like courses from the mouth out; that the left jawbone was gone and that the roof of the mouth was broken in about five pieces which were held together by pieces of connecting tissue so that they might be pushed into something near the original groove to form the contours of the face, the nose and the upper part of the jaw bone; that an examination of the head cavity showed that blood and matter were oozing into the wound through the breaks in the skull and the skull was found to be loose and soft and could easily be manipulated with the hand; that the left eye was out of the socket and lay upon the temporal part of the head; that other than the protruding jaw bone there was no wound on the right side of the face, but that there was a fan-like tear on the left side extending from the point of the chin left to the neck about three inches long, but no hole or wound that could be distinguished beneath the point of the chin

on either side, and portions of the flesh, presumably of the left cheek, were found scattered at various places and distances from the body at the time the body was found. Having this in mind, and in the light of my experiences, I would think that the muzzle of gun that brought about the damage was probably in the individual's mouth at the time of the explosion. This would be so because of the nature of the injury. In my experience with shotgun wounds at close range, there is an absolute destruction of the tissue at the point of entrance, and in this instance there were tears from the mouth radiating on the left side of the face as much as several inches, back to the ear, down to the neck, and upward. That would indicate that there was an explosive effect, rather than a discharge of the shot alone. I do not believe that a charge of shot entering at some distance, or at any distance, the body and face would have caused such as wound as this. I can hardly explain the fracture of the right jaw in any other way than by the explosive action of the gas, the explosion at the muzzle of the gun which is always present at the firing of any gun.

CROSS EXAMINATION BY MR. JONES:

I don't know that it would have blown his head off if the muzzle of the gun had been in his mouth when the gun was fired. It was a twelve-gauge Winchester pump shotgun, but I would not say that it would blow his head off. If the muzzle was in his mouth, it should have damaged the upper plate; if it was in the path of the shot, it would have broken it. As I understand it, the path of the shot

was outward toward the left cheek; the cheek was blown out, radiating tears from the mouth backward, upward and downward. I don't think that if the gun had been in the side of the face it would blow the entire side of the face away instead of just leaving tears radiating out. I have never seen a case where the shotgun exploded in the mouth of anyone. In war service, wounds I saw were largely gunshot wounds and high explosives. I never saw any shotgun wounds during my service.

I don't think that if the load from the shotgun had struck the chin and gone along the side of the face it would result in the same wound as has been described. The actual destruction, and by that I mean the actual destruction of the tissue itself, is caused by the charge of shot; and in addition to that, there would be some destruction by the explosive effect. Wherever the shot took effect there would be an absolute destruction of all tissue. I have only seen one case of a shotgun wound of the face. It blew the whole right side of the face off, destroying the tissue. It was at very close range. If this were in the mouth, it would be at close range; likewise if it were under the chin. The eyeball could be blown out of its socket whether the malar bone was broken or not.

HOWARD PACKHAM, recalled as witness on behalf of the defendant, previously being sworn, testified as follows:

DIRECT EXAMINATION BY MR. SHIELDS:

As I remember the upper plate of the deceased's artificial teeth, the right side of the plate was entirely in-

tact. The plate itself was all there, and the teeth were all there on the right side, but on the left side some of the teeth were broken or chipped with part of the teeth still in the plate and some entirely gone, with one or two scattered over the left side of the plate. I did not find those teeth. I don't remember anything definitely about the front part of the teeth.

IRA COREY, recalled as witness on behalf of the defendant, previously being sworn, as follows:

DIRECT EXAMINATION BY MR. BISTLINE:

Since testifying this morning I have been out to the barn where the body of John D. Bowman was found on February 16, 1937, going out there at 12:40 today. I measured the distance across and the circumference of the shot that hit the wall, and the distance from the floor to the top of the sill at the window, and the distance from the floor to where the shot were in the roof, and from the floor to the cross bar, and from the cross bar up to the sheeting, and the distance of where the flesh is north from the cross bar. The window on which the flesh was showing was the south window on the west end of the barn. The diameter of the shot pattern I found to be eight inches. It was in the roof right where the cross bar connects to the rafter, just where they come together as the shot hit. The shot marks on the west side of the rafter were there and closer in, and from these I could observe the course of the shot from the marks. They had come nearly straight up and down, slanting just a little to the south and a trifle to the east. There was a little slope

a little in the southeasterly direction. It was fifty-seven inches from the floor to the bottom of the window sill. I didn't measure the size of the window. The canvas was still hanging on it, appearing to be exactly the same. It was one one hundred and sixteen inches from the floor up to the shot pattern, which was the distance also to the cross bar on which the flesh rested. It was twenty-eight inches from this cross bar to the roof of the loft from the point where I saw flesh on the rafter of the building; twenty-five inches to the place on the gable where there was flesh. It was thirty-eight inches from the pattern on the roof to where the flesh was on the ceiling, and also on the cross bar.

CROSS EXAMINATION BY MR. JONES:

There was other flesh than on the pattern. The imprint of the shot was on the rafter and in the sheeting, not in the shingles, but the cross bar, rafter, and some in the sheeting, and some into the shingles. This was the only place where the shot had taken effect and was almost straight up from where the body lay, about two feet to the south of where the feet were on the ceiling, inside the walls and on the roof.

Defendant rests.

MR. SHIELDS: If the court please, comes now the defendant the Kansas City Life Insurance Company and moves the Court to instruct the jury in this case to bring in a verdict in favor of the defendant so far as the claim or demand of the plaintiff is concerned with respect to

double idemnity in this case on the ground that no cause of action is shown here, and I will submit it, if the Court please.

THE COURT: That request will be denied.

MR. SHIELDS: And we may have an exception?

THE COURT: Yes, the exception is allowed.

INSTRUCTIONS TO THE JURY:

THE COURT: Gentlemen of the jury, because of the apparent agreement of counsel that there is but one controlling issue in this case, it will be unnecessary to give my instructions a very wide range.

The plaintiff's claim grows out of a contract commonly called or known as a life insurance policy. As in the case of any other contract, such a policy is binding upon all the parties thereto, and the beneficiaries of the insured. By its terms all the rights and obligations of the parties, including the litigants here, the plaintiff and defendant company are defined. In the light of the instructions I give you and the evidence before you, you are to adjudge the rights of the parties fairly and impartially and to render a true and impartial verdict free from all other consideration.

It was competent for the parties to make such agreement as they saw fit to make, and it is your duty as jurors and my duty as presiding judge to enforce the contract as it is written and hold the company to its liability as such liability is defined in the contract of insurance, called the policy, but not beyond that.

I should say to you further that you are not to deal in mere surmises or conjecture as to how the death of the insured occured. You are to base your findings upon the facts as they are before you, the testimony of the witnesses who have testified before you, and all the facts and circumstances in evidence and reasonable inferences from the proven facts. It is frequently necessary to rely upon inferences to some extent, but they must be inferences and not mere guesses, conjectures, surmises or imagination. Your verdict must be based upon facts. By facts, I mean facts themselves and rational legitimate fair inferences drawn therefrom.

Now then, passing to the consideration of the policy and the real critical issue, the policy provides for insuring the life of John D. Bowman in the sum of two thousand five hundred dollars and provides for and agreed to pay Bertha E. Bowman, the wife of John D. Bowman, the beneficiary therein named, the sum of five thousand dollars, being double the face amount of the policy in the event of accidental death of John D. Bowman, as defined in the policy. It is conceded that the decedent John D. Bowman died from a gunshot wound and there were no other contributing causes. It therefore follows that if the plaintiff is entitled to recover on the item of insurance in the event of accidental death resulting directly and independently from all other causes, from bodily injuries effect solely through external, violent, and accidental means, that is five thousand dollars, if she is entitled to recover on that item; and if she is not entitled to recover

on that item, she would be entitled to recover the sum of two thousand five hundred dollars.

This is a contract subject to all of the ordinary considerations of a contract, binding upon both parties, and with only such rights and obligations as it defines. It was entirely competent for the insurance company to write a policy excluding its double liability if death was caused by suicide. It did choose to do so, and the insured did not choose to have a policy covering suicide for double indemnity, hence there is no double indemnity for death resulting from intentional or self-inflicted wounds, or suicide. If the insured committed suicide, plaintiff should recover only two thousand five hundred dollars; hence if under the instructions I have given you, and from the evidence you find suicide, then your verdict will be for the plaintiff for only two thousand five hundred dollars.

The burden is on the plaintiff to prove by a preponderance of the evidence the facts alleged in her complaint. The answer alleges that the death of the insured, John D. Bowman, was caused by suicide.

Now, gentlemen, the responsibility is upon you fairly and conscientiously to weigh all of the evidence in the case and to determine this controlling issue. The burden of proof, as I have indicated to you, was upon the plaintiff, and in order to recover against the defendant the sum of five thousand dollars, being the double indemnity, the plaintiff must prove that the injury resulted directly and independently of all other causes from accidental bodily injury, and this accidental bodily injury was not caus-

ed by means or acts self-inflicted by the insured, and unless the plaintiff has established these facts by a preponderence of the evidence, that is, unless the facts appear by a preponderance of all of the evidence before you, the plaintiff can only recover the sum of two thousand five hundred dollars.

I need hardly say to you that a preponderance of the evidence does not necessarily mean the greater number of witnesses; it means the greater weight of the testimony or evidence, before you taken as a whole. This is the primary meaning of preponderance and is the meaning used in the law.

It is admitted that the premiums on the policy were paid and that it was in full force and effect at the time of the death of the insured, John D. Bowman, and it is also admitted that there was made due and sufficient proof of death.

As already explained to you, if you find from a preponderance of the evidence that the death of John D. Bowman, the insured by accident resulting directly and independently from all other causes from bodily injury effect solely through external, violent and accidental means, you will find for the plaintiff for five thousand dollars. On the other hand, if you do not find from a preponderance of the evidence that the death of John D. Bowman, the insured, was caused by accident resulting directly and independently from all other causes from bodily injury effect solely through external, violent and accidental means, then your verdict should be in favor

of the plaintiff for only two thousand five hundred dollars.

It is your duty, gentlemen, to follow the instructions in good faith and try to apply them to the evidence fairly and impartially, entirely apart from any consideration except the facts in this case, and conscientiously and impartially render a verdict. The fact that one party is a corporation and the other a natural person, you must disregard.

All of you must concur in finding a verdict. A form of verdict has been prepared. You will have no difficulty in using it. You will notice a blank space left, and as you reach your verdict you will insert therein the amount you arrive at. Your foreman alone need sign the verdict. I will hand you the complaint, the answer and the verdict.

Let the bailiff be sworn and you may retire with the bailiff.

MR. SHIELDS: We would like to save an exception to the instructions.

THE COURT: You may have an exception.

(Whereupon, upon a rendition of a verdict in favor of the plaintiff in the sum of $5,000.00, the following proceedings were had.)

MR. BISTLINE: We would like an exception, and our motion made for an order or a regular order entered as to the time allowed for the preparation of a bill of exceptions.

THE COURT: You may have your exception; you will have to take that and make your record.

The following orders extending time for preparation, settlement and filing of this Bill of Exceptions (omitting captions) were made and entered:

"The time to file the bill of exceptions and statement of the case by defendant in the above entitled cause is hereby extended to May 27, 1938, and the present term of court is hereby extended for such purposes.

Dated at Pocatello, Idaho, this 28th day of March, 1938."

"The time to file the bill of exceptions and statement of the case by plaintiff in the above entitled cause is hereby extended to July 26, 1938, and the present term of Court is hereby extended for such purpose.

Dated at Pocatello, Idaho, this 27th day of May, 1938."

"The time to file the bill of exceptions and statement of the case by defendant in the above entitled cause is hereby extended to August 15, 1938, and the present term of court is hereby extended for such purpose.

Dated this 18th day of July, 1938."

That on April 20, 1938, defendant filed and served upon plaintiff motion for new trial as follows:

"Comes now the defendant, Kansas City Life Insurance Company, a corporation and moves the Court for new trial of the above entitled cause upon the following grounds, to-wit:

1. That the evidence is insufficient to justify the verdict in the following particular, to-wit: That there is no evidence whatsoever that the death of John D. Bowman resulted directly and independently of all other causes

from bodily injuries affected solely through external, violent and accidental means, which is required by the provisions of the insurance policy sued upon.

2. Error in law occuring at the trial in that the Court erred in not granting defendant's motion for a directed verdict in that there is no evidence whatsoever that the death of John D. Bowman resulted directly and independently of all other causes from bodily injuries affect solely through external, violent and accidental means, which is required by the provisions of the insurance policy sued upon.

This motion is based upon the minutes of the court and the records and files in the above entitled cause."

That said motion was duly heard by the Court on June 15, 1938, and denied, and order denying same made and entered on said date, to which ruling of the court denying said Motion, exception was made by the defendant and allowed by the Court.

(Title of Court and Cause)

STIPULATION

In this cause it is stipulated by and between the respective parties, through their counsel of record, that the proposed Bill of Exceptions heretofore prepared and lodged is a true, correct, and a complete and perfect Bill

of Exceptions, and that the plaintiff and respondent has no objections thereto or corrections or amendments to offer; and that the same may be settled, signed, sealed, allowed, and certified as the Bill of Exceptions herein, and that there may be included therein the orders extending the time for the settlement of the bill of Exceptions since said Bill of Exceptions was lodged, and that said orders may be made a part thereof and included therein.

It is further stipulated and agreed that said Hon. C. C. Cavanah may sign, seal, settle, allow and certify said Bill of Exceptions at such time and place as said Hon. C. C. Cavanah shall desire; and that the plaintiff and respondent and her counsel waive any notice of the signing, sealing, settling and certifying of said Bill of Exceptions, or the time and place thereof; and said plaintiff and respondent and her counsel waive their right to be present thereat, or notice thereof.

DATED At Pocatello, Idaho, this 15th day of August, 1938.

Dan B. Shields,
F. M. Bistline,
Attorneys for Defendant.

Jones, Pomeroy & Jones,
T. D. Jones,
Attorneys for Plaintiff.

(Title of Court and Cause)

CERTIFICATE OF JUDGE TO BILL OF EXCEPTIONS.

I, C. C. Cavanah, United States District Judge, before whom the above-entitled action was tried do hereby certify that the matters and proceedings embodied in the foregoing Bill of Exceptions are matters and proceedings occurring in said cause, and the same are hereby made a part of the record therein, and that the above and foregoing Bill of Exceptions contains all the material facts, matters, and proceedings heretofore occurring in said cause and not already a part of the record therein; and contains all the instructions of the Court, and all of the evidence, oral and in writing therein, and is a true BILL OF EXCEPTIONS, and the above and foregoing Bill of Exceptions was duly and regularly filed with the Clerk of the said Court and thereafter duly and regularly served within the time authorized by law and the rules of the United States District Court in the District of Idaho; and that no amendments were proposed to said Bill of Exceptions excepting such as are embodied therein; and that due and regular notice of time for settlement and certifying said Bill of Exceptions was waived by stipulation of counsel, and the said stipulation is hereby made a part of the Bill of Exceptions; that said Bill of Exceptions was duly lodged, notice served on appellee's counsel, and was signed and settled by the Court within the time

authorized by the Court by orders made extending the time for the settling and filing of said Bill of Exceptions, which said orders extending the time are hereby made a part of the Bill of Exceptions.

Done at Boise, Idaho, this 29th day of August, 1938.

CHARLES C. CAVANAH,
District Judge.

(Title of Court and Cause)

ORDER EXTENDING TIME TO FILE BILL OF EXCEPTIONS.

Filed March 28, 1938.

The time to file the bill of exceptions and statement of the case by defendant in the above entitled cause is hereby extended to May 27th, 1938, and the present term of court is hereby extended for such purpose.

Dated at Pocatello, Idaho, this 28th day of March 1938.

CHARLES C. CAVANAH,
District Judge.

(Service accepted March 28, 1938.)

(Title of Court and Cause)

ORDER EXTENDING TIME TO FILE BILL OF EXCEPTIONS

Filed May 25, 1938.

The time to file the bill of exceptions and statement of the case by plaintiff in the above entitled cause is hereby extended to July 27th, 1938, and the present term of court is hereby extended for such purpose.

Dated at Pocatello, Idaho, this 25th day of May, 1938.

CHARLES C. CAVANAH,
District Judge.

(Service Accepted May 27, 1938.)

(Title of Court and Cause)

ORDER EXTENDING TIME FOR FILING BILL OF EXCEPTIONS AND EXTENDING TERM OF COURT.

Filed July 18, 1938.

The time to file the bill of exceptions and state of the case by defendant in the above entitled cause is hereby extended to August 15th, 1938, and the present term of court is hereby extended for such purpose.

Dated this 18th day of July, 1938.

CHARLES C. CAVANAH,
District Judge.

(Service Accepted)

(Title of Court and Cause)

ORDER

Filed August 8, 1938.

Application of the defendant now being made for further extension of time within which to prepare bill of exception and extending the term of Court in the above cause, and after consideration of the same the Court denies said application or the granting of Order extending the time for filing bill of exceptions and extension of the term of Court in said cause.

Dated August 8th, 1938.

CHARLES C. CAVANAH,
District Judge.

(Title of Court and Cause)

PETITION FOR APPEAL

Filed August 31, 1938.

TO THE HON. CHARLES C. CAVANAH, Judge of the District Court of the United States of America in and for the District of Idaho, Eastern Division:

Your petitioner, Kansas City Life Insurance Company, a corporation, who is defendant in the above entitled cause, prays that it may be permitted to make an appeal from the judgment entered in the above cause on the

26th day of March, 1938, to the United States Circuit Court of Appeals of the Ninth Circuit, for the reasons specified in the Assignments of Error which are filed herewith and your petitioner desires that an order be made fixing the amount of security which said petitioner and defendant shall give to furnish or secure the costs upon appeal and to supersede and stay the judgment pending appeal.

Dated this 30th day of August, 1938.

DAN B. SHIELDS,
F. M. BISTLINE,
Attorneys for Petitioner,
Kansas City Life Insurance
Company, a corporation.

(Service Accepted August 30, 1938.)

(Title of Court and Cause)

ASSIGNMENT OF ERRORS.

Filed August 31, 1938.

Defendant and appellant, Kansas City Life Insurance Company, a corporation, in connection with its petition for an appeal in the above entitled cause, files the following assignments of error upon which it will rely in the prosecution of the appeal herewith petitioned for in said cause:

1. The court erred in denying defendant's motion for nonsuit at the close of the plaintiff's case.

2. The Court erred in denying defendant's motion for a directed verdict at the close of all of the evidence.

3. The court erred in denying defendant's motion for a new trial.

4. That the verdict of the jury was and is contrary to the evidence.

5. The judgment of the court entered herein is contrary to the law.

6. That the evidence was and is insufficient to support a verdict for the plaintiff in excess of $2,500.00 and accrued interest thereon for the reason that there is no evidence that the insured, John D. Bowman, came to his death by accidental means.

7. That the verdict of the jury is contrary to the evidence for the reason that taking the evidence as a whole, the physical facts are such that they conclusively establish that John D. Bowman's death resulted from suicide.

8. The court erred in entering judgment against the defendant and in favor of plaintiff for the reason that there is no evidence in the record to support said judgment, and that said judgment is contrary to the evidence and contrary to law and that the evidence does not, as a matter of law, justify a judgment in favor of plaintiff.

Dan B. Shields,
F. M. Bistline,
Attorneys for Appellant.

(Service Accepted August 30, 1938.)

(Title of Court and Cause)

ORDER ALLOWING APPEAL

Filed August 31, 1938.

Upon the Petition for Appeal, accompanied by assignments of error heretofore filed herein, it being made to appear that said petition should be allowed,

IT IS ORDERED that said petition for appeal be and is hereby granted and the appeal allowed; and that upon the giving of a cost bond in the sum of $300.00 and a supersedeas bond in the sum of $6,000.00 all proceedings to enforce the judgment herein shall be stayed until said appeal shall be determined, the bonds to be approved by the Court.

Dated the 31st day of August, 1938.

CHARLES C. CAVANAH,
District Judge.

(Title of Court and Cause)

BOND

Filed August 31, 1938.

WHEREAS, the Defendant, Kansas City Life Insurance Company, in the above entitled action, is about to appeal to the Ninth Circuit Court of the United States,

from a judgment made and entered against it in the above entitled court on the 26th day of March, 1938, in favor of the Plaintiff, Bertha E. Bowman, for the sum of FIVE THOUSAND ($5,000) DOLLARS.

NOW THEREFORE, IN CONSIDERATION OF THE PREMISES and of such appeal, the undersigned, does hereby undertake and promise on the part of the Defendant, that the said Defendant will pay all damages and costs which may be awarded against it on the appeal, or on a dismissal thereof, not exceeding the sum of ($300.00) THREE HUNDRED DOLLARS, to which amount the undersigned acknowledges itself bound, and

WHEREAS, the Defendant herein is desirous of staying the execution of said judgment so appealed from, the undersigned does further, in consideration thereof and of the premises, undertake and promise, and does acknowledge itself to be further bound in the further sum of SIX THOUSAND ($6000.00) DOLLARS, lawful money of the United States, that if the said judgment appealed from, or any part thereof, be affirmed or the appeal be dismissed, the Defendant will pay the amount directed to be paid by the said judgment, or the part of such amount as to which the said judgment shall be affirmed if affirmed only in part, and all damages and costs which may be awarded against the Defendant upon such appeal, and if the Defendant does not make payment of such judgment within thirty (30) days after the filing of the

remittitur from the Ninth Circuit Court of the United States, in the court from which the appeal is taken, judgment may be entered upon motion of the plaintiff in her favor and against the undersigned Surety, for such amount, together with interest that may be due thereon, and the damages and costs which may be awarded against the Defendant upon the appeal.

AMERICAN SURETY COMPANY
OF NEW YORK
By J. A. HODSON,
Resident Vice-President.
Attest: M. KLOTZ,
Resident Asst. Secretary.

(SEAL) Countersigned: A. B. CHASE,
Resident Agent at Pocatello, Idaho.

Approved:
August 31,st, 1938.
Charles C. Cavanah,
Judge.

(Title of Court and Cause)

CITATION ON APPEAL.

Filed September 2, 1938.

UNITED STATES OF AMERICA—ss.

To the plaintiff, Bertha E. Bowman, and her attorneys, Jones, Pomeroy & Jones, of Pocatello, Idaho: GREETINGS:

You are hereby cited and admonished to be and appear at the United States Circuit Court of Appeals for the Ninth Circuit, at the City of San Francisco, State of California, within thirty days from the date hereof, pursuant to an order allowing appeal from the District Court of the United States in and for the District of Idaho, Eastern Division, in a suit wherein Kansas City Life Insurance Company is appellant, and you, the said Bertha E. Bowman, is the appellee, to show cause, if any there be, why a judgment rendered against Kansas City Life Insurance Company, a corporation, should not be corrected, and why speedy justice should not be done to the parties on that behalf.

WITNESS the HONORABLE CHARLES C. CAVANAH, Judge of the District Court of the United States in and for the District of Idaho, Eastern Division, this the 31st day of August, 1938.

(SEAL) CHARLES C. CAVANAH,

District Judge.

ATTEST:

W. D. McREYNOLDS, Clerk.

(Service Accepted September 1, 1938.)

(Title of Court and Cause)

ACKNOWLEDGMENT OF SERVICE.

Filed September 2, 1938.

Service of the Following papers, for and on behalf of

the plaintiff, and for and on behalf of ourselves, the undersigned, is admitted:

Cost bond on appeal and Supersedeas Bond
Praecipe for transcript of record
Order allowing Appeal
Citation on Appeal
Petition for Appeal, and
Assignment of Errors.

Dated this 1st day of Sept., 1938.

JONES, POMEROY & JONES,
Attorneys for Plaintiff.

(Title of Court and Cause)

PRAECIPE FOR TRANSCRIPT OF RECORD.

Filed September 2, 1938.

TO: The Clerk of the above entitled Court, Hon. W. D. McReynolds, and the plaintiff, Bertha E. Bowman, and her attorneys, Jones, Pomeroy & Jones, of Pocatello, Idaho:

The Clerk is hereby requested to make a transcript of the record to be filed in the United States Circuit Court of Appeals of the Ninth Circuit, pursuant to an appeal allowed in the above entitled cause, and to include in such

transcript of the record the following and no other papers, and exhibits, to-wit:

1. The Judgment Roll, consisting of:
2. The complaint.
3. The order for removal to Federal Court.
4. Defendant's Answer.
5. Verdict of jury.
6. Judgment. Also, the
7. Order overruling motion for new trial.
8. Bill of Exceptions, duly settled and allowed by the Court, including all orders extending the time for filing the bill of exceptions; and certify up all exhibits introduced in evidence.
9. All minute entries and orders made in said cause from the beginning to the end thereof.
10. Petition for appeal.
11. Assignments of error.
12. Order allowing appeal.
13. Cost and supersedeas bond on appeal, showing approval by the Court.
14. Citation on appeal, including acknowledgement of service thereof by the plaintiff and his counsel, or proof of service thereof.
15. Stipulations between counsel fied in this case.
16. This praecipe, together with acknowledgement or proof of service thereof.

Said transcript to be prepared as required by law and the rules of this Court, and the rules of the United States Circuit Court of Appeals, Ninth Circuit, and to be filed in the United States Circuit Court of Appeals for the Ninth Circuit.

DATED This 1st day of Sept., 1938.

F. M. BISTLINE,
DAN B. SHIELDS,
Attorneys for Appellant
Kansas City Life Insurance Co.

(Service accepted September 1, 1938.)

(Title of Court and Cause)

CERTIFICATE OF CLERK.

I. W. D. McReynolds, Clerk of the District Court of the United States for the District of Idaho, do hereby certify the foregoing transcript of pages numbered from 1 to 125 inclusive, to be full, true and correct copie of the pleadings and proceedings in the above entitled cause, and that the same together constitutes the transcript of the record herein upon appeal to the United States Circuit Court of Appeals for the Ninth Circuit, as requested by the Praecipe filed herein.

I further certify that the cost of the record herein

amounts to the sum of $152.65 and that the same has been paid by the appellant.

Witness my hand and the seal of said Court this 28th day of September, 1938.

(SEAL) W. D. McREYNOLDS,
Clerk.

No. 8993

IN THE

United States Circuit Court of Appeals
FOR THE NINTH CIRCUIT

KANSAS CITY LIFE INSURANCE COMPANY, a Corporation,

Appellant,

vs.

BERTHA E. BOWMAN,

Appellee.

Appeal From the District Court of the United States for the District of Idaho, Eastern Division

APPELLANT'S BRIEF

DAN B. SHIELDS,
F. M. BISTLINE,
Attorneys for Appellant.

No. 8993

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United States Circuit Court of Appeals
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Appeal From the District Court of the United States for the District of Idaho, Eastern Division

---

APPELLANT'S BRIEF

DAN B. SHIELDS,
F. M. BISTLINE,
Attorneys for Appellant.

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No. 8993

IN THE

United States Circuit Court of Appeals
FOR THE NINTH CIRCUIT

KANSAS CITY LIFE INSURANCE COMPANY,
a Corporation,

Appellant,

vs.

BERTHA E. BOWMAN,

Appellee.

Appeal From the District Court of the United States for the District of Idaho, Eastern Division

---

APPELLANT'S BRIEF

JURISDICTIONAL FACTS

Bertha E. Bowman, a citizen of Idaho, filed her complaint in the District Court of the Fifth Judicial District of the State of Idaho in and for Bannock County, on October 25, 1937 (p. 1) against the Kansas City Life Insurance Company, a corporation existing under and by virtue of the laws of the State of Missouri, for the sum of $5,000.00. There being a diversity of citizenship and the amount involved being in excess of $3,000.00 (U. S. C. A. Title 28, Section 41 (1)) appellant removed the case to the Federal court for the District of Idaho, the order (p. 33) therefor having been made by the judge of said District Court on December 2, 1937, and filed in said Federal Court on December 2, 1937. (U. S. C. A. Title 28, Section 71.) After removal of the cause to Federal Court,

defendant filed its answer on the 25th of February, 193[illegible] (p. 35).

Judgment for plaintiff was entered March 26, 193[illegible] (p. 41). On April 20, 1938, defendant filed and serve[illegible] upon plaintiff Motion for New Trial (p. 109) pursuan[illegible] to Rule of the District Court as follows:

> "Rule 75. (Idaho District Court) Within Thirt[illegible] days after the entry of judgment, the applican[illegible] shall serve upon the adverse party and file wit[illegible] the Clerk a petition for a new trial, stating th[illegible] grounds upon which he relies, * * * * * ."

This motion for new trial was over-ruled on June 1[illegible] 1938. (p. 110.) Under said rule 75, the time for appea[illegible] was stayed until the disposition of said petition for ne[illegible] trial, said rule being as follows:

> "A petition for a new trial served and filed unde[illegible] this rule shall be deemed to be entertained by th[illegible] Court, and shall suspend the operation of the judg[illegible] ment, and of any process that may have been issue[illegible] thereon, and of any writ of error that may hav[illegible] been granted; and thereafter no writ of error sha[illegible] be taken out, or any process issued upon said judg[illegible] ment until the disposition of said petition for ne[illegible] trial."

Appellant appealed and order allowing appeal wa[illegible] filed August 31, 1938. (p. 118.)

STATEMENT OF THE CASE

John D. Bowman died February 16, 1937, by gunsho[illegible] His life was insured by a policy with appellant by whic[illegible] it agreed to pay his beneficiary (plaintiff and appellee[illegible] $2,500 upon proof of death regardless of cause or $5,00[illegible]

in case of accidental death as defined by a provision of the policy, the pertinent parts of which are:

> "The additional sum payable in event of the accidental death of the Insured shall be due if the Company shall receive due proof * * * that such death resulted directly and independently of all other causes from bodily injuries, effected solely through external, violent and accidental means * * * except that this double indemnity benefit shall not be payable if the insured's death shall result directly or indirectly, wholly or partly from suicide, whether sane or insane * * * * *." (p. 20.)

Appellee sued for $5,000. The Complaint alleges that the death of the insured resulted directly and independently of all other causes from bodily injuries effected solely through external, violent and accidental means, to-wit, by the accidental discharge of a shot gun, which struck the person and body of the said John D. Bowman (p. 30).

Defendant's answer conceded that plaintiff is entitled to the face of the policy, and offers judgment for that amount. It denies that death resulted from bodily injury effected through accidental means and specifically alleges that the death of the insured resulted from suicide. (p. 35.)

The case came on for trial, and at the close of plaintiff's case defendant moved for nonsuit upon the ground that plaintiff had not established accidental death. This motion was denied (p. 38). At the close of all the evidence defendant moved for a directed verdict upon the ground that no cause of action was shown from the evidence, which was also denied (p. 105).

The jury gave plaintiff a verdict for $5,000 with interest and the court entered judgment in her favor for

that amount. Defendant moved for a new trial upon the ground that the evidence was insufficient to justify the verdict in that there was no evidence that the death of the Insured resulted directly and independently of all other causes from bodily injuries effected solely through external, violent and accidental means, and that the court further erred in not granting plaintiff's motion for a directed verdict on said ground.

The only question involved is the sufficiency of the evidence, it being contended by appellant that there is no evidence in the record that insured's death resulted from bodily injuries effected through external, violent and accidental means alone. This question was raised by defendant's motions for non-suit, for directed verdict, and for new trial, all of which were denied and exceptions taken.

In order that this question may be properly presented, we deem it necessary at this point to set out succinctly the facts and circumstances surrounding the death of said Insured, same being:

On December 1, 1935, deceased, John D. Bowman, suffered a cerebral thrombosis, a clot on the brain which produces an action akin to paralysis (p. 81). As a result of this he was very ill and was confined to bed about six or seven weeks (p. 75). His right side was paralyzed. Improvement from that time continued until the time of his death, at which time his physical condition was, to outward appearances, about normal, with the exception of his speech and his right hand. He couldn't grasp objects as he did before his sickness, at times dropping articles, such as dishes when he was wiping them. Cold weather would cause his right hand to become numb. He had a rather pronounced speech impediment; articulation was difficult and he could speak but a few words at a time.

After he was able to be out of bed, he gradually resumed doing chores, such as herding the cows, supervising the irrigating, driving the hay derrick for about two hundred tons of hay, helping with the threshing, feeding the cows and horses, repairing the machinery and driving a car around the farm.

About one-thirty on the day of his death, February 16, 1937, he went to his son's home and got the shotgun (Exhibit 1). As he left the house with the gun, his daughter-in-law, Verna A. Bowman, followed him to the door, and as he opened the door the birds flew out of the tree and he said "birds." She also noticed that he talked to the children and tapped or touched them on the heads as he was leaving, and that he appeared cheerful and smiled all the time. He was next seen by his son Bertram N. Bowman taking the gun toward his own house. About two-thirty that same afternoon he was seen at the store in Blackfoot operated by Brigham Horrocks by said Brigham Horrocks. He took two shot gun shells without waiting to be served. He was familiar with the store, having previously worked there for about a month. When he showed Horrocks the two shells, Horrocks said to him: "You don't want them. Leave them here." and Bowman told him he was going to shoot "birds."

Bowman was next seen by Verna A. Bowman about 3:30 that same afternoon going toward the barn. About five minutes later she heard a shot from the direction of the barn. At that time she was in the process of changing straw in the chicken coop and went on about her work and later went into the house, whence she heard another shot fired about 20 minutes after the first one. It also came from the direction of the barn. At the time she noticed a lot of birds flying around.

Deceased was found in the hay loft of the barn back of the sugar factory at Blackfoot, Idaho, about 4:20 that same afternoon by John N. Barnard (p. 61), who in tracing the source of blood on the back of his horses went to the hay loft and found Mr. Bowman lying on his back in the southwest corner of the hay loft just under a window which had no glass in it. He did not examine the body at that time, but notified one of the Bowman boys, who in turn notified the sheriff and coroner. The Sheriff, Coroner, Jack Gibbs, two of the Bowman boys and John Barnard went to the hay loft of the barn at about five o'clock that same afternoon and made observations as to the location of the body in the barn, the position of the body and its condition, as well as the condition of the loft in the vicinity of the body.

They found the body of deceased lying on his back, diagonally with the head to the southeast and the gun diagonally across the body with the butt between the feet of the deceased. The muzzle was just a little to the left of the position of the heart of the body. The left hand was lying down at his side. The sheriff picked up the gun and ejected an empty shell. The gun had blood stains on it. A little piece of flesh was in the muzzle and fell out when the sheriff tipped the gun up. The trigger hammer was down pressing the firing pin against the shell. There was one empty shell at the right side of the body.

The hay mow was empty with the exception of a few alfalfa leaves on the floor of the barn. The ceiling was bare; a little to the left and over the body was the pattern of a charge of shot that had entered the roof at the juncture of a rafter and a cross member. There was a little piece of denim pinned to the roof by a shot at that point. There were some small particles of flesh and blood with stains there, and from there north for a distance of probably

six feet were pieces of flesh up in the roof and some particles on the cross bar or the binder of the building. At the window just west of the body were small particles of flesh and bloody spots on the sill. This window was about three feet square and about five feet from the base of the window to the floor. Particles of flesh rested on the edge of the sill at the bottom of the window. His feet were in front of that window about 18 inches from the wall. No shots were found in the barn other than the pattern immediately above the body.

The left side of Bowman's face was gone and there was no mouth. The left eye was out of the socket, lying over with the flesh. He wore artificial teeth and his lower plate was broken into pieces in several places and lying with the mangled part of his face, and the upper plate was out lying along the side of the face. There was not much blood on the floor, but part of the face was injured and bloody. The different parts of the face were not distinguishable, being commingled with the flesh and torn parts of the face. The left ear was practically covered with a piece or pieces of flesh lying back over it.

The body was removed to the undertaking parlor where a further examination was made which disclosed that in addition to the above that the left eye was completely out of the socket, lying on the temporal region of the left side; the left ear was split from the lobe up about half way in the ear, and there were about three distinct rents or tears in the flesh of the left cheek which seemed to be more of a fan-like shape. The right jaw bone was broken and protruded through the skin. The head of the deceased was loose to the touch and not solid. The mouth was entirely shot away. The roof of the mouth was in about five different pieces connected only by some so-called connective tissue, with blood or matter of some sort oozing

through these breaks. On the underside of the chin wa a tear about three inches long extending somewhere o the left side sort of diagonally down toward the side o the neck. The flesh remained where the tear was, goin down under part of the chin on both sides; not very muc of the chin was left on the left side. Practically the entir left side of the face was gone. The tears of the chee could not be reconstructed definitely into their origin shape, but could be reshaped only to a point about midwa of the cheek (p. 86). On the left shoulder was a scratch o scar about two inches long extending from about the nippl upward and slightly toward the left shoulder.

At the time of his death, Mr. Bowman was wearin the jumper (Exhibit 3) and the shoes (Exhibit 2) wit rubbers over them, trousers and an ordinary gray wor shirt (p. 63). The jumper had two holes in it to the le of the lapel. (p. 66).

Deceased's family relations had always been good an on the date of the death he was of cheerful dispositio

The sheriff tested the gun by dropping it sever times a distance of one foot to see if it would discharg from impact, but it would not do so. (p. 88.)

It is appellant's contention that the facts, which ar as above set forth, are not sufficient to establish th the deceased came to his death "from bodily injurie effected solely through external, violent and accident means."

ASSIGNMENT OF ERRORS

1. The court erred in denying defendant's motio for nonsuit at the close of the plaintiff's case.

2. The Court erred in denying defendant's motio for a directed verdict at the close of all of the evidenc

3. The Court erred in denying defendant's motion or a new trial.

4. That the verdict of the jury was and is contrary o the evidence.

5. The judgment of court entered herein is contrary o the law.

6. That the evidence was and is insufficient to support a verdict for the plaintiff in excess of $2,500.00 and ccrued interest thereon for the reason that there is no vidence that the insured John D. Bowman, came to his eath by accidental means.

7. That the verdict of the jury is contrary to the vidence for the reason that taking the evidence as a whole, e physical facts are such that they conclusively establish at John D. Bowman's death resulted from suicide.

8. The court erred in entering judgment against the efendant and in favor of plaintiff for the reason that ere is no evidence in the record to support said judgment, nd that said judgment is contrary to the evidence and ontrary to law and that the evidence does not, as a matter law, justify a judgment in favor of plaintiff.

SUMMARY OF ARGUMENT

All the errors assigned are to the same effect: That ere is no evidence to prove that Bowman's death was cidental.

The burden was on plaintiff to prove by a preponderice of the evidence that the deceased met his death by ccident as defined in the contract of insurance, that is; te beneficiary has the burden of proof that the insured's eath resulted solely from accidental means within double idemnity meaning of the life policy.

New York Life Insurance Co. vs. Gamer, 303 *U. S. S Ct.* 161, 82 *L. Ed.* 480.

Frankel vs. New York Life Insurance Co., 51 *Fed.* (2*d* 933, 935.

Supreme Tent K. of M. vs. King, 142 *Fed.* 678.

New York Life Insurance Company vs. Anderson, 6 *Fed.* (2*d*) 707.

Presumption that a violent death was accidental rathe than suicidal is not evidence and may not be given weigh as evidence.

New York Life Insurance Co. vs. Gamer, 303 *U. S. S Ct.* 161, 82 *L. Ed.* 480, 484.

Despiau vs. United States Casualty Co. (*C. C. A. 1st* 89 *F.* (2*d*) 43, 44.

Jefferson Standard Life Insurance Co. vs. Clemme (*C. C. A. 4th*) 79 *F.* (2*d*) 724, 103 *A. L. R.* 171.

Travelers Insurance Company vs. Wilkes, (*C. C. A 5th*) 76 *F.* (2*d*) 701, 705.

Fidelity & Casualty Company vs. Driver (*C. C. A. 5th* 79 *F.* (2*d*) 713, 714.

Frankel vs. New York Life Insurance Co., (*C. C. A 10th*) 51 *F.* (2*d*) 933, 935.

Ocean Accident & G. Corp. vs. Schachner, (*C. C. A 7th*) 70 *F.* (2*d*) 28, 31.

A verdict cannot rest upon mere speculation and co jecture. Whenever circumstantial evidence is relied up to prove a fact, the circumstances must be proved and n themselves presumed. Speculation and conjecture are n enough, and a verdict that rests upon speculation a conjecture cannot be allowed to stand.

Pennsylvania Railroad Co. vs. Chamberlain, 77 *L. Ed.* 825; 288 *U. S.* 333.

Chicago, M. & St. P. R. Co. vs. Coogan, 271 *U. S.* 472, ; 70 *L. Ed.* 1041, 1045; 46 *S. Ct.* 564.

Gulf, M. & N. R. Co. vs. Wells, 275 *U. S.* 455, 459; *L. Ed.* 370, 372; 48 *S. Ct.*, 151.

New York C. R. Co. vs. Ambrose, 280 *U. S.* 486, 74 *Ed.* 562, 50 *S. Ct.*, 198.

Stevens vs. The White City, 285 *U. S.* 195, 76 *L. Ed.* 704, 52 *S. Ct.* 347.

Del Vecchio vs. Bowers, 296 *U. S.* 280; 56 *S. Ct.* 190; *Ed.* 229.

New York Life Ins. Co. vs. Anderson, (*C. C. A. 8th*) . (2*d*) 705.

Frankel vs. New York Life Insurance Co., (*C. C. A.*) 51 *F.* (2*d*) 933.

New York Life Insurance Co. vs. Alman, (*C. C. A.* 22 *F.* (2*d*) 98.

Burkett vs. New York Life Insurance Co., (*C. C. A.* 56 *F.* (2*d*) 105.

Johnson vs. Industrial Commission, 35 *Ariz.* 19; 274 51.

Hawkins vs. Kronick Cleaning & Laundry Co., 157 *n.* 33; 195 *N. W.* 766.

Chaudiers vs. Sterns & Culver Lumber Co., 173 *N. W.* 201.

It is a matter of common knowledge that persons nit suicide notwithstanding abundant reasons to be fied with their lot in life.

Burkett vs. New York Life Ins. Co., (*C. C. A.* 5) 56 *F.* (2*d*) 105.

New York Life Ins. Co. vs. Trimble, (*C. C. A.* 5) 69 *F.* (2*d*) 849, 851.

Aetna Life Insurance Co. vs. Tooley, (*C. C. A.* 5) 16 *F.* (2*d*) 243, 244.

In the following cases it was held as a matter of law that there was no evidence to support a verdict resting upon accidental death.

Frankel vs. New York Life Insurance Co., 51 (2*d*) 93.

Burkett vs. New York Life Insurance Co., 56 **F.** (2d) 105.

New York Life Insurance Co. vs. Anderson, 66 **F.** (2d) 707.

Fidelity & Casualty Co. of New York vs. Driver 79 *F.* (2*d*) 713.

New York Life Insurance Co. vs. Alman, 22 **F.** (2*d*) 8.

Aetna Life Insurance Co. vs. Tooley, 16 **F.** (2*d*) 3.

New York Life Insurance Co. vs. Trimble, 69 **F.** (2d) 849.

Sugar vs. Industrial Commission of Utah, 75 **P.** (2d) 311.

Aetna Life Insurance Company vs. Alsobrook, 29 *S. W.* 743.

Fidelity Mutual Life Insurance Co. vs. Wilson, 2 *S. W.* (2*d*) 80.

Love vs. New York Life Insurance Co., (*C. C. A.* 5th) 65 *F.* (2*d*) 829.

ARGUMENT

In view of the fact that all of the assignments of error nd upon assignment six, we are taking up the argument at first.

> "6. That the evidence was and is insufficient to support a verdict for the plaintiff in excess of $2,500 and accrued interest thereon for the reason that there is no evidence that the insured John D. Bowman came to his death by accidental means."

The burden was upon plaintiff to establish by a preerance of the evidence that the deceased met his death eged. The plaintiff proved no other facts than that sed came to his death from gun shot wound. The n was upon her to prove that the discharge of the vas accidental.

The Supreme Court of the United States has set at all doubt upon this question and in a very recent uncement upon appeal from this court, said:

> "Under the contract in the case now before us, double indemnity is payable only on proof of death by accident as there defined. *The burden was on the plaintiff to allege and by a preponderance of the evidence to prove that fact.* The complaint alleged accident and negatived self-destruction. The answer denied accident and alleges suicide. Plaintiff's negation of self-destruction, taken with defendant's allegation of suicide, served to narrow the possible field of controversy. Only the issue of accidental death vel non remained. The question of fact to be tried was precisely the same as if the plaintiff merely alleged accidental death and the defendant interposed denial without more." (Italics supplied.)

New York Life Ins. Co. vs. Gamer, 303 *U. S. S. Ct.* 16, 82 *L. Ed.* 460.

See also:

Frankel vs. New York Life Insurance Co., 51 *F.* (2d) 933.

Supreme Tent K. of M. vs. King, 142 *F.* 678.

New York Life Insurance Co. vs. Anderson, 66 *F.* (2d) 707.

There were no eye-witnesses to this death. As to how the gun was discharged is not known but the burden was on plaintiff to prove that fact. That the gun may have been accidentally discharged by dropping or in some other manner is of course a possibility, but certainly not a probability in view of no showing that it was or could be so discharged.

> "Verdicts must rest on probabilities, not on mere possibilities."

Love vs. New York Life Insurance Co., 64 *F.* (2d) 829, 832.

Samulski vs. Menasha Paper Co., 147 *Wis.* 285, 33 *N. W.* 142, 145.

United States vs. Crume (*C. C. A.*) 54 *F.* (2d) 556, 558.

New York Life Insurance Co. vs. Trimble, 69 *F.* (2d) 849, 850.

The possibility of an accidental discharge of this gun was left entirely to the imagination of the jury. Plaintiff made no attempt to prove that it was possible for this gun to be discharged other than by pulling the trigger. The theory of accidental discharge was left entirely to speculation and conjecture. And a verdict cannot rest upon

peculation and conjecture. The circumstances must be proved and not presumed.

Pennsylvania Railroad Co. vs. Chamberlain, 77 *L. Ed.* 819, 825; 288 *U. S.* 333.

Chicago, M. & St. P. R. Co. vs. Coogan, 271 *U. S.* 472, 478; 70 *L. Ed.* 1041, 1045; 46 *S. Ct.* 564.

Gulf M. & N. R. Co. vs. Wells, 275, *U. S.* 455, 459; 72 *L. Ed.* 370, 372; 48 *S. Ct.* 151.

New York C. R. Co. vs. Ambrose, 280 *U. S.* 486; 74 *L. Ed.* 562, 50 *S. Ct.* 198.

Stevens vs. The White City, 285 *U. S.* 195; 76 *L. Ed.* 699; 52 *S. Ct.* 347.

Del Vecchio vs. Bowers, 296 *U. S.* 280; 56 *S. Ct.* 190; 80 *L. Ed.* 229.

New York Life Insurance Co. vs. Anderson, 66 *F.* (2*d*) 705.

Frankel vs. New York Life Insurance Co., 51 *F.* (2*d*) 933.

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Johnson vs. Industrial Commission, 35 *Ariz.* 19; 274 *P.* 161.

Hawkins vs. Kronick Cleaning & Laundry Co., 157 *Minn.* 33; 195 *N. W.* 766.

Chaudier vs. Sterns & Culver Lumber Co., 173 *N. W.* 183.

It may be that plaintiff was attempting to rely upon the presumption that a person will not kill himself, as

evidence of accidental death, but if so, the Supreme Court of the United States in the very recent case of *New York Life Insurance Co. vs. Gamer*, (supra) very definitely ruled that out when it held:

> "The presumption is not evidence and may not be given weight as evidence."

New York Life Insurance Co. vs. Gamer (*supra*) 8: *L. Ed.* 484.

Despiau vs. United States Casualty Co., 89 *F.* (2d 43, 44.

Jefferson Standard Life Insurance Co. vs. Clemmer 79 *F.* (2*d*) 724, 730; 103 *A. L. R.* 171.

Travelers Insurance Co. vs. Wilkes, 76 *F.* (2*d*) 701 705.

Fidelity & Casualty Co. vs. Driver, 79 *F.* (2*d*) 713, 71

Frankel vs. New York Life Insurance Co., 51 *F.* (2d 933, 935.

Ocean Accident & G. Corp. vs. Schachner, 70 *F.* (2*d*) 2 31.

Thus, under these rules, the plaintiff is left with n evidence whatsoever that the deceased's death was th result of accident.

MOTIVE

During trial, plaintiff's counsel argued to some exter that there was a lack of motive for suicide. We are no concerned with motive, as the burden of disproof is upo the plaintiff.

> "It is a matter of common knowledge that persor commit suicide notwithstanding abundant reasor to be satisfied with their lot in life."

Burkett vs. New York Life Insurance Co., 56 *Fed.* (2*d*) 105, 107.

> "Motive is helpful but is not essential. This is so because in this life men who have no apparent motive for it, do commit suicide. Perhaps always in the case of a sane person who commits suicide there is motive, but in many cases the motive is not and could not be proved."

New York Life Insurance Co. vs. Trimble, 69 *F.* (2*d*) 849, 851.

Aetna Life Insurance Co. vs. Tooley, 16 *F.* (2*d*) 243, 244.

Burkett vs. New York Life Insurance Co., 56 *F.* (2*d*) 105.

However, it is our contention that the evidence shows that motive was not lacking: Here is a man who had been stricken with cerebral thrombosis, which in all likelihood would leave him permanently disabled (Tr. 82, 98). Men in that condition have been known to commit suicide much more frequently than men who are in good health and have all their faculties. His actions within three hours of his death were unusual. A crippled man getting a gun and carefully explaining that he was going to shoot birds and patting his grandchildren on the heads (Tr. 44), walking an aggregate distance of two or more miles to get two shells, and going to the extreme effort of pulling himself up into the hay mow with a crippled arm—all this only to shoot sparrows with only two shot gun shells—and then shooting himself with one of them in such a way as to blow his left cheek into shreds, which lay outward, and shooting away his entire mouth, would, we believe, indicate to the normal person that this man had other

motives in his mind than just shooting at sparrows for the welfare of the farm. But even if these circumstances did not exist, it did not relieve plaintiff of the burden of proving the death by accident and this she did not do.

The physical facts in the case clearly indicate that the deceased took his own life, and particularly the fact that his face was blown from the inside outward, (Tr. 85) that a piece of flesh fell from the end of the muzzle of the gun when the sheriff picked it up (Tr. 88) and the further and most significant fact that the gun could not be discharged accidentally, as shown by a thorough test made by the sheriff shortly after the accident (Tr. 88)

In the following cases, evidence was examined by the appellate courts and held to be evidence of suicide and not accident.

Frankel vs. New York Life Insurance Co., 51 *Fed.* (2d) 933.

Burkett vs. New York Life Insurance Co., 56 *F.* (2d) 105.

New York Life Insurance Co. vs. Anderson, 66 *F.* (2d) 707.

Fidelity and Casualty Co. of New York vs. Driver, 7? *F.* (2*d*) 713.

New York Life Insurance Co. vs. Alman, 22 *Fed.* (2d) 98.

Aetna Life Insurance Co. vs. Tooley, 16 *F.* (2*d*) 243

New York Life Insurance vs. Trimble, 69 *F.* (2*d*) 849

Sugar vs. Industrial Commission of Utah, 75 *P.* (2d) 311.

Aetna Life Insurance Co. vs. Alsobrook, 299 *S. W.* 743

Fidelity Mutual Life Insurance Co. vs. Wilson, 2 *S. W.* (2*d*) 80.

Love vs. New York Life Insurance Co., 65 *F.* (2*d*) 829.

But, it was not for defendant to prove suicide; the burden was on plaintiff to prove death by accident.

Taking up the remaining assignments of error, to-wit:

"1. The court erred in denying defendant's motion for nonsuit at the close of the plaintiff's case.

"2. The Court erred in denying defendant's motion for a directed verdict at the close of all of the evidence.

"3. The court erred in denying defendant's motion for a new trial.

"4. That the verdict of the jury was and is contrary to the evidence.

"5. The judgment of the court entered herein is contrary to the law.

"7. That the verdict of the jury is contrary to the evidence for the reason that taking the evidence as a whole, the physical facts are such that they conclusively establish that John D. Bowman's death resulted from suicide.

"8. The court erred in entering judgment against the defendant and in favor of plaintiff for the reason that there is no evidence in the record to support said judgment, and that said judgment is contrary to the evidence and contrary to the law, and that the evidence does not, as a matter of law, justify a judgment in favor of plaintiff."

Appellant adopts the argument of assignment 6 in suppor of its contention that the court erred in these other respects

CONCLUSION

The burden of proving that the death of the decease was by accident is on the plaintiff. It is submitted tha she failed to meet this burden by any evidence, let alon the preponderance thereof, and that therefore, the refusa of the court to grant defendant's motion for nonsuit, th motion for directed verdict, and motion for new trial wer error prejudicial to defendant; and that the judgmen should be reversed.

Respectfully submitted,

DAN B. SHIELDS,
F. M. BISTLINE,
Attorneys for Appellant

No. 8993

IN THE

United States Circuit Court of Appeals

KANSAS CITY LIFE INSURANCE COMPANY,
a Corporation,

Appellant,

vs.

BERTHA E. BOWMAN,

Appellee.

Brief of Appellee

Appeal from the District Court of the United States for the District of Idaho, Eastern Division.

T. D. JONES
C. W. POMEROY
RALPH H. JONES
Attorneys for Appellee

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Brief of Appellee

STATEMENT OF THE CASE

The statement of the case made by appellant is substantially correct, except the statement of the facts surrounding the death of the insured is incomplete and omits some very material evidence bearing upon the case. In view of which we deem it necessary to make a succinct statement of the facts shown by the record.

John D. Bowman died February 16, 1937, from gun-shot wound. He was a resident of Blackfoot, Idaho, at the time of his death and was survived by his wife Bertha E. Bowman, with whom he had been married for thirty-five years and had lived in Idaho twenty-two years, at Riverside and Blackfoot, and since 1934 at Blackfoot. Their children were grown; they had one son who was in college at the time of the accident. Mr. Bowman was engaged in farming. His family relationship was good and he had always been very devoted to his wife and kind during the whole of their married life.

His financial condition was good as he never did go in debt and was not in debt at the time of his death (p. 75). On December 1, 1935, deceased, John D. Bowman, suffered a stroke or cerebral thrombosis. Cerebral thrombosis is a clot on the brain which produces an action akin to paralysis and does produce paralysis depending on the amount of damage to the brain tissue and on the pressure (p. 81) or the edema. If there is an actual destruction of the brain tissue or the nerve cells they never regenerate, but if the paralysis is through edema they will gradually come back as the pressure is released. Where there is a good recovery it demonstrates that there was not much destruction of the brain cells (p. 82). There was a good recovery in this case (p. 82).

His right side was paralized and he was confined to bed about six or seven weeks. After he got out of bed he continued to improve up until the day of his death (p. 75). At the time of his death his physical condition was perfect with the exception of his speech and his right hand (p. 76), and he was about the same weight he was before his illness, having regained his normal weight (p. 49); he couldn't grasp things like he did before his sickness, his grip wasn't as good with his right hand (p. 47), and at times he dropped objects and especially dishes when he was wiping them (p. 76). He had a rather pronounced speech impediment and difficulty with his right hand (p. 79). After he was able to be out of bed he did many things around the home: He milked the cows and chopped the kindling, shovelled snow (p. 78), did other chores consisting among other things, in feeding and watering horses, cows, calves, and milking cows. The decedent at times

went up in the loft of the barn to feed hay to the stock (p. 51). In addition, he would do most everything around the farm. In the summer of 1936, after the stroke, he did some irrigating; he supervised all of the irrigating (p. 46); drove the derrick team for about two hundred tons of hay (p. 53); helped with the threshing and repairing of machinery; drove the Plymouth car around the farm practically all summer (p. 53).

After the stroke he spent his evenings listening to radio, reading the papers, going to shows, entertainments and political rallies, and always went to Blackfoot, about a mile from their home, twice a week, on Wednesdays and Saturdays, to the barber shop, and nearly always walked. At numerous times he talked about his physical condition (p. 76) and stated that he was better and went through movements to show how his arm was better and how much stronger and better it was (p. 77), and told his boys in the presence of his wife that he wanted to help them with the crops in the spring of 1937, and planned to take a trip with his wife to California in June as soon as their son was out of college (p. 76). He stated he was going to help the boys run the farm the coming summer (pp. 46, 53).

The day before his death the decedent, John D. Bowman, hitched up some colts to break, and helped repair a sleigh tongue (p. 53).

On the day of his death he got up and made the fires and after breakfast went to the barnyard to help haul some hay (p. 77).

There were a lot of birds around the barn and around the feed lot adjoining the barn and in the loft of the barn (p. 47), and the decedent had a custom of shooting birds on the farm (p. 76). He shot birds at the place where they were living in the winter of 1934 (p. 76). There were two guns in the house of decedent after the stroke, one a twenty-two caliber and the other Exhibit 1. The twenty-two was always in decedent's house and there were twenty-two shells always there for it but the decedent never kept any shotgun shells in the home at any time (p. 77). The shotgun, Exhibit 1, was not always in the house. It was loaned to members of the family part of the time (p. 76) and it would be brought back and put where it was always kept in the clothes closet (p. 77). It was in the decedent's house during the summer he was recovering from the illness (p. 77), but it was not there for about six weeks before the decendent got it on the date he was killed. It was at that time being used to shoot birds on the feed yard adjoining the barn about every day (p. 79). The decedent was at home alone from time to time and for as much as three days at a time during his convalescence (p. 77).

The gun, Exhibit 1, was found by the family of the decedent on the Lincoln Creek divide in a damaged condition and the stock thereof was afterward repaired (p. 50). It is a twelve-gauge Winchester repeating shotgun. After the decedent's death it was bought by Barris from the Boyle Hardware and was taken apart and cleaned. The works of the gun were all gummed with hard grease and grit and it was corroded (p. 52).

The day of his death, February 16, 1937, the decedent was in his home at noon, ate a hearty dinner, helped his wife clear up the table and wiped the dishes (p. 77). At about 1:30 he went to his son's home, which is about two hundred or two hundred fifty feet northwest of the barn, and got the shotgun, Exhibit 1 (p. 43). He appeared as he always did, cheerful and smiled all the time. He was informed by his daughter-in-law Verna A. Bowman that there were no shells for the gun. As he left the house with the shotgun, Exhibit 1, birds flew out of the trees and he motioned to the birds flying around from the trees and said, "Birds" (p. 44).

About 1:30 or 2:30 in the afternoon he was seen just inside the barnyard gate between the house of Bertram M. Bowman and the barn taking the gun toward the house of decedent (p. 46). About 2:30 the same afternoon he was at the store of the Clegg Furniture Company in Blackfoot, Idaho, and was seen by Brigham Horrocks who was in the merchandising business under the name of Clegg Furniture Company. Mr. Horrocks stated that decedent took two twelve-gauge shotgun shells without waiting to be served. The decedent was familiar with the store, having previously worked there for about a month in the winter. When decedent showed Horrocks the two shells Horrocks said to him, "You don't want them. Leave them here," in a kidding way. Mr. Horrocks stated, "I always kidded with him and he did with me," and that "there was nothing unusual in this. He told me he was shooting birds and I knew it was his custom." The decendent said, "I am going to shoot birds." It was the habit (p. 59) of decedent to buy shotgun shells two or three at a time and

never more than a quarter's worth. This continued over a period of five years or longer than that (p. 60). It was the custom of the decedent to wait upon himself if there was no one ready to wait upon him (p. 60).

The decedent was next seen by Verna A. Bowman on the day of his death about 3:30 going towards the barn. She was at the chicken coop at that time and was in the process of changing straw. There was no obstruction between the chicken coop and the barn to prevent a person from seeing from one place to the other (p. 45). About five minutes from the time she saw the decedent going toward the barn she heard a shot coming from the direction of the barn and noticed birds flying in all directions. She went to the house and later heard another shot fired about twenty minutes after the first shot. It also came from the direction of the barn (pp. 45, 70). There were two houses to the north of the barn and she lived in the one to the south. The barn was south and east of her house and the chicken coop diagonally to the south between the barn and the house (p. 45).

Deceased was found in the hay loft of the barn back of the sugar factory at Blackfoot, Idaho, at about 4:20 that same afternoon by John N. Barnard (p. 61), who, in tracing the source of the blood on the back of his horses which had been kept in some stalls in the barn, went to the hay loft and found Mr. Bowman lying on his back in the southwest corner of the hay loft just under a window which had no glass in it. He did not examine the body at that time but notified one of the Bowman boys of the accident, who in turn notified

the sheriff and coroner. The sheriff, coroner, Jack Gibbs, two of the Bowman boys and John Barnard went to the hay loft of the barn. The body was in the same position and condition when the coroner arrived (p. 61), about 5:00 o'clock (p. 65) as it was when first seen by Barnard.

They found the body of the decedent lying on his back in the southwest corner of the barn near the window, his head to the southeast not quite in line with the barn (p. 62), his feet were about one and a half feet from the west wall and a little north—about four inches—of the southwest window (pp. 54, 62).

The gun was lying diagonally across the body near the feet. The butt was near the feet but not quite in line with the body (p. 65), and the muzzle pointed towards the left side of his head and still lying on his chest (pp. 63, 65). There was an empty shell to the right of the body and another empty shell which was extracted from the gun (p. 65). There was no contrivance of any kind that could be used there at all (p. 65, 94). The only thing found around the body was a piece of 2" x 4", which was three or four feet long with some alfalfa leaves on it (p. 94) which was south and east of the body, which had not been used for any purpose as the leaves had not been disturbed (p. 95).

When the gun was picked up a little piece of flesh was in the muzzle and fell out when the sheriff tipped the gun up and there were blood stains on the gun (p. 88). The trigger hammer was down pressing the firing-pin against the shell.

The decedent Bowman had been shot in the left side of

his face (p. 65). Part of the chin and the jaw bone on the left side had been shattered and the left side, extending to the eyes, was pretty well torn away (p. 67). The wound was the entire length of the left side of the face from the chin clear up past the eye (p. 68). The eye was dropping out of the socket a little. The cause of that was possibly a destruction of the muscle of the cheek bone which was depressed. It was in the area of the external wound on the left side of the face in the same place (p. 81). The left side of his face was pretty well shot away indicating that the shot had probably been under the left side of the chin where the shot first went in (p. 66). The roof of the mouth was in about five different pieces (p. 85) still connected together by some connecting tissue. They were not wholly destroyed, there being enough to distinguish that it was the roof of the mouth (p. 86).

The upper plate of the decedent's artificial teeth was all there and intact. The teeth were all there on the right side but on the left some of the teeth were broken or chipped with part of the teeth still in the plate (p. 101-102). The lower plate was broken to pieces in several places and lying with the mangled part of his face (p. 89). Neither plate was in his mouth, the upper plate being to the left of his face and right along the torn part of his face (p. 90).

There was a little of the skin of the mouth visible. There was no flesh noticed down underneath the jaw (p. 73).

The ceiling was bare and a little to the left and over the body was the pattern of a charge of shot that had entered the roof at the juncture of the rafter and the cross-member (p. 88).

The shot pattern on the ceiling was almost directly over decedent's feet (p. 56).

There were particles of flesh and blood where the shot took effect in the barn and also particles of the blue denim jumper embedded at that place and particles of flesh spattered about. There were no other shots that took effect in the barn (p. 72).

There were no marks or wounds on the right side of the decedent's face except the right jaw bone which protruded through the skin about three inches between the point of the chin and the right ear. The head of the deceased was loose to the touch and not solid (p. 85).

There was a friction mark or what might be called an abrasion along the left side starting at the nipple and terminating at the collar bone.

The body was taken to the mortuary. It was dressed in a jumper (Exhibit 3) and sweater that was under the jumper, usual underwear (p. 66), khaki pants, shoes (Exhibit 2) on with rubbers on over the shoes, and an ordinary gray work shirt (p. 63). The shoes (Exhibit 2) were in the same condition as they were at the time of the death of the decedent (p. 57). The denim jumper had two holes in it. The shot looked as if it had struck the left side of his coat and gone into his chin and took the left side of his face off (p. 63). The shot that went through his face would have to go through the hole in his jumper before it hit his face (p. 93).

The barn is a frame structure about 28' x 46'. It has a gable roof and tie arms across the rafters. It is about ten feet from the hay loft floor to the tie arms. There are two

windows in the west and two in the east and a large hay door between the east two. The windows are between two to three feet square and are about four and a half feet from the floor of the loft of the barn and have no glass in them. The oat granary is back of the barn on the west side down below the southwest window with a lean-to roof to the south and the doors to this granary were never very tight for birds would always fly out of there. There was also a wheat granary where seed wheat was stored and birds could get in there to some extent (p. 48). Access to the loft of the barn was gained by a perpendicular ladder on the north side of the barn to reach the loft (p. 54).

Melvin Bowman is 5' 6" tall, and compared with his father John D. Bowman, there is not the fraction of an inch difference in the two of them. Their build is practically the same; their arms were about the same length (p. 54); they are the same dimensions generally. Melvin Bowman stepped down from the witness box in front of the jury and the stock or butt of the gun, Exhibit 1, was placed on the floor by his feet with the gun in nearly a perpendicular position to the floor in line with his body with the muzzle or end of the barrel pointing upward along side his left breast, and in this position he was requested to reach the trigger with his finger, but the witness was unable to reach the trigger with his finger while the gun was in this position without bending his body. With the gun in the same position he then bent over and pressed the trigger with his finger and in so doing the muzzle or end of the barrel extended above the top of the left shoulder of the witness (p. 57).

POINTS AND AUTHORITIES

The weight, sufficiency or probative force of the evidence is for the jury.

> Gold Hunter Mining & Smelting Co. vs. Johnson, 233 F. 849, 147 C. C. A. 523;
>
> Supreme Lodge K. of P. vs. Beck, 181 U. S. 49; 45 L. Ed. 741.

The court is justified in directing a verdict only when the testimony will not support any other verdict.

> U. S. Fidelity & Guaranty Co. vs. Blake, 285 F. 449; certiorari denied, 43 S. C. Ct. 523; 262 U. S. 748;
>
> Tipsword vs. Potter (Idaho), 174 Pac. 133;
>
> Smith Booth Usher Co. vs. Detroit Copper Mining Co. of Ariz., 220 F. 600, 136 C. C. A. 58;
>
> Southern Pac. Co. vs. U. S., 22 F. 46, 137 C. C. A. 584;
>
> McAlinden vs. St. Maries Hospital Ass'n, 156 Pac. 115, 28 Ida. 657;
>
> Gamer vs. N. Y. Life Ins. Co., 76 F. (2d) 543;
>
> N. Y. Life Ins. Co. vs. Gamer, 303 U. S. S. Ct. 161, 82 L. Ed. 480-484.

In actions on double indemnity clause of life policy where death of insured can be accounted for upon any reasonable hypothesis other than suicide, case for jury.

> Gamer vs. N. Y. Life Ins. Co., 76 F. (2d) 543;

Conn. Gen. Life Ins. Co. vs. Maher, (C. C. A.) 70 F. (2d) 441-445.

In determining whether or not evidence is sufficient to submit the case to the jury the court will assume that the jury will take the view most favorable to opposing party.

N. Y. Life Ins. Co. vs. Gamer, 303 U. S. S. Ct. 161, 82 L. Ed. 480-484;

Gamer vs. N. Y. Life Ins. Co., 76 Fed. (2d) 543;

Gamer vs. N. Y. Life Ins. Co., 90 Fed. (2d) 817.

Inferences from evidence where fair minded men might honestly differ as to the conclusion to be drawn from facts whether controverted or not, the question at issue is for the jury.

Adams vs. Bunker Hill & Sullivan Min. Co., (Idaho), 89 Pac. 624;

Brown vs. Jaeger, (Idaho) 271 Pac. 464.

Evidence reasonably tending to prove, either directly or by permissible inferences, the essential facts, is sufficient to sustain verdict of the jury.

Midland Valley R. Co. vs. Goble, 186 Pac. 723;

Missouri O. & G. Ry. Co. vs. Smith, 155 Pac. 233;

Ruerat vs. Stevens, (Conn.) 155 A. 219;

Brooks-Bischoffberger vs. Bischoffberger, (Me.) 149 A. 606;

Buttrick vs. Snyder, 210 N. W. 311 (236 Mich. 300).

Facts from which another fact may be rationally inferred are evidence of that fact.

Olberg vs. Kroehler, 1 F. (2d) 140;

Perry vs. Johnson Fruit Co., 243 N. W. 655 (Nebr.);

Nardone vs. Public Service Electric & Gas Co., 174 A. 745 (N. J.)

If there is any doubt as to the inferences to be drawn from the evidence, it is for the jury.

Rhoads vs. Herbert, (Pa.) 148 A. 693-694.

Finding reasonably inferable from facts and conditions directly proved is "legal evidence" and not mere conjecture.

Horrick vs. Bethlehem Mines Corp., 161 Atl. 75, (307 Pa. 264).

The plaintiff is not bound to prove by eye-witnesses that the injuries which caused insured's death were accidental, but the fact may be shown by circumstantial evidence.

Wilkinson vs. Aetna Life Ins. Co., (Ill.) 88 N. E. 550;

U. S. Fidelity & Guaranty vs. Blum, (C. C. A.) 270 F. 946;

Cooley's Briefs on Insurance, Vol. 6, p. 5287;

Gamer vs. N. Y. Life Ins. Co., 76 F. (2d) 543.

Experimental evidence depends for its value on the fact that the experiment has been made when the conditions affecting the result are as nearly as may be identical with those existing at the time of and operating to produce the same effect.

> People vs. Woon Tuck Wo., (Cal.) 52 Pac. 833;
>
> Maris vs. Crummey, (Cal.) 204 Pac. 259;
>
> 22 C. J. Page 758, Sec. 852;
>
> American Bell Tel. Co. vs. Nat'l Tel. Mfg. Co. 109 F. 976.

ARGUMENT

While appellant makes eight separate assignments of error, it is conceded in appellant's brief, at Page 9, that they are all to the same effect, that there is no evidence to prove that Bowman's death was accidental. Appellant devotes its entire argument in its brief to assignment six.

> "That the evidence was and is insufficient to support a verdict for the plaintiff in excess of $2,500 and accrued interest thereon for the reason that there is no evidence that the insured John D. Bowman came to his death by accidental means."

It will be observed by Page 19 of appellant's brief that the argument made in support of assignment No. 6 is adopted for the remaining assignments of error, to wit:

> "1. The court erred in denying defendant's motion for nonsuit at the close of the plaintiff's case.
>
> "2. The court erred in denying defendant's motion for a directed verdict at the close of all of the evidence.

"3. The court erred in denying defendant's motion for a new trial.

"4. That the verdict of the jury was and is contrary to the evidence.

"5. The judgment of the court entered hereein is contrary to the law.

"7. That the verdict of the jury is contrary to the evidence for the reason that taking the evidence as a whole, the physical facts are such that they conclusively establish that John D. Bowman's death resulted from suicide.

"8. The court erred in entering judgment against the defendant and in favor of plaintiff for the reason that there is no evidence in the record to support said judgment, and that said judgment is contrary to the evidence and contrary to the law, and that the evidence does not, as a matter of law, justify a judgment in favor of plaintiff."

EVIDENCE SUFFICIENT TO SUPPORT VERDICT

The courts attention is called to the fact that on the day of the death that the decedent's body was found at the southwest window of the barn with his feet within about eighteen inches of the west wall and the north side of the window, with his head lying in a southeasterly direction, with one empty shell lying near him and the other in the gun which was lying on his body. There were two holes in the jumper decedent was wearing in the left side near the breast and there was a wound in the left side of his face showing that the shot had entered under the left part of his chin and gone along the side of his face and into the rafter and cross-pieces of the ceiling almost directly over the feet of the decedent. The fact that there were shreds and particles of the blue denim jumper worn by the

decedent in the shot pattern above in the ceiling showed that the shot which passed through the blue denim coat was the shot that struck the left side of the decedent's face and entered the ceiling above.

The fact that no other shot took effect in the barn leads reasonably to the conclusion that the first shot was fired through the open window, and that the second shot which occurred some twenty minutes after the first shot, was the shot that inflicted the wound in decedent's face and killed him.

The evidence further discloses there was no contrivance around the body of the decedent by which the trigger could have been pressed or touched by the decedent. The shape and size of the shoes and rubbers over them, Exhibit 3, worn by the decedent were such that the decedent could not have pressed the trigger by his foot. Moreover, the record discloses (p. 57) that Melvin Bowman, son of the decedent, who was practically the same height and build as the decedent, with arms about the same length (p. 54), made a demonstration of the gun, Exhibit 1, before the jury to determine whether it would be possible for the decedent to have pressed the trigger of the gun with his finger and received the wound that was inflicted. In making the demonstration, the stock or butt of the gun was placed on the floor by his feet, with the gun in a perpendicular position to the floor in line with his body with the muzzle or end of the barrel pointing upward along the side of his left breast, and while in this position he was unable to reach the trigger with his finger without bending. He then bent over and pressed the trigger with his finger and while he was in this

position the muzzle or end of the barrel extended above the top of his left shoulder (p. 57), which conclusively demonstrated to the jury that the decedent could not have touched the trigger of the gun with his finger, and from such proven facts the jury could and would naturally infer that the gun was discharged accidentally.

Evidence reasonably tending to prove, either directly or by permissible inferences, the essential facts, is sufficient to sustain a judgment.

> Midland Valley Ry. Co. vs. Goble, 186 Pac. 723;
>
> Missouri O. & G. Ry. Co. vs. Smith, 155 Pac. 233.

Facts from which another fact may be rationally inferred are evidence of that fact.

> Olberg vs. Kroehler, 1 F. (2d) 140.

In the case of Butrick vs. Snyder, (Mich.) 210 N. W. 311, the court in its opinion, commencing at the bottom of p. 312, said:

> "While it is true that a verdict may not rest upon bare conjecture (Fuller vs. Ann Arbor Railroad Co., 141 Mich. 66, 104 N. W. 414), it is also true that a finding as to a particular fact may be based upon inferences fairly drawn from other facts established by proof. Waidelich vs. Andros, 182 Mich. 374, 148 N. W. 824. The burden was on the plaintiff to prove that the dynamite caps were left in the tool shed by defendant's employees. If unable to furnish positive evidence of this fact, he might establish it by circumstantial proof of such a nature as would create a probability sufficiently strong to lead the jury to conclude that such

> was the fact. Dunbar vs. McGill, 64 Mich. 676, 31 N. W. 578. The reasonable inferences which may be drawn from the affirmative facts proven are evidence, and not presumptions.
>
> "Applying these rules to the proofs submitted, we are of the opinion that the finding of the jury that the dynamite was left in the shed by the stone company did not rest on conjecture."

It is contended in the brief of appellant, at p. 18, that the gun could not have been discharged accidentally, as shown by a test made in the sheriff's office in the evening of the same day. In this connection the record shows that the only test made was by cocking the gun and dropping it several times to the floor a distance of one foot to see if the jar would set the gun off, and by such test the gun did not go off (p. 88).

The test made in the sheriff's office had no probative value in determining whether or not the gun would go off by a jar if it were dropped against the floor a greater distance than one foot, or even one foot under different conditions.

Experimental evidence in corroboration of disproof depends for its value on the fact that the experiment has been made when the conditions affecting the result are as nearly as may be identical with those existing at the time of and operating to produce the particular effect.

People vs. Woon Tuck Wo, (Cal.) 52 Pac. 833;

Maris vs. Crummey, (Cal.) 204 Pac. 259.

The burden is on the party making the experiment to show similarity of essential conditions.

People vs. Hill, (Cal.) 56 Pac. 443;

People vs. Wagner, (Cal.) 155 Pac. 649;

22 C. J. Sec. 852, pp. 758-9.

The appellant failed to show that the conditions were similar. The test was made in the sheriff's office during winter weather (p. 58) by cocking a hammerless gun and dropping it to the floor a distance of one foot for several times. Whereas, the evidence was that the body was found in the loft of a barn, and it is not shown that the temperature was the same in the loft of the barn as it was in the sheriff's office. Nor was it shown that the floor of the sheriff's office was a bare floor such as the floor of the loft of the barn; nor whether the floor of the sheriff's office was carpeted or otherwise. It was not shown whether the firing device was in contact in the same manner or that the gun was loaded at the time of the test, or that the firing parts were in contact in the same manner as when the decedent met his death, or that the force was applied at the same angle or same distance in dropping the gun. It is apparent that the conditions were so absolutely dissimilar that the evidence offered by the test made in the sheriff's office would not show whether the gun would go off accidentally by a jar from dropping the same when the accident occurred.

The record shows that there were two shots fired and that only one load took effect in the barn, which naturally forces the conclusion that the other shot must have been fired through the open window where the body was later found. The jury had a right to conclude that a man 5' 6" tall, firing a shot

through the window, would be holding the butt of the gun against his shoulder, which would be about five feet from the floor, and holding the gun normally, waiting to fire or in the process of raising it to shoot again through the window, the butt of the gun would be from two to five feet from the floor, and that dropping the butt of the gun from such a distance would considerably more than double the force that was applied by the sheriff in the test made.

The test so made by the sheriff, although offered in evidence, was a matter for the jury to determine whether or not it had sufficient weight to be of any importance in the case.

Courts may properly take judicial notice of facts that may be regarded as forming part of the common knowledge of every person of ordinary understanding and intelligence.

23 C. J. 59 Sec. 1810;

23 C. J. 173 Sec. 2007.

The record discloses that the gun, Exhibit 1, was old and that when it was taken apart after the death of decedent the mechanism and works of the gun were all gummed with hard grease and grit and that it was corroded (p. 52).

It is common knowledge that difference in temperature, whether the device is clean or dirty, whether well oiled or gummed, whether the force of contact is applied in the same direction, or with the same force, makes a difference in the operation or failure of operation of any mechanical device. Every such person knows that when the mechanism of a gun is gummed with hard grease, corroded, and full of grit, it will

not work as accurately and properly when cold as when the gun is warm.

It is contended by appellant in its brief on Page 18 that the physical facts indicate that the deceased took his own life because his face was blown from the inside outward and a piece of flesh fell from the end of the gun when the sheriff picked it up. It is submitted that such contention is fallacious for the following reasons: It is apparent that where the gun was discharged along the side of the decedent's face in such close proximity that flesh would naturally be blown in many directions, as particles of flesh were found in several places. The record does not disclose as contended by appellant that the face was blown from the inside outward. It was sought to be shown by the appellant that the muzzle of the gun was placed in the mouth of decedent, which was the theory upon which the appellant tried its case. The appellant's expert, Dr. Newton, in answer to a hypothetical question, stated (pp. 98, 99, 100) that he thought that the muzzle of the gun that brought about the damages was probably in the decedent's mouth at the time of the explosion, but the doctor stated that he had only seen one case of gunshot wound and that was in the face. He further stated that there would be an absolute destruction of the tissue where the charge of the shot took effect (p. 101), and stated that if the muzzle was in the mouth it would have broken the upper plate, yet the evidence shows that there was connecting tissues in the roof of the mouth and that the upper plate was not broken although there were some teeth chiped or broken (pp. 101-2) on the left side of the plate, confirming the fact that the shot was along the left

side of the face. Moreover, the lower plate was broken to pieces (p. 89), showing that the shot entered under the left part of the chin and went up along the left side of the face rather than in the mouth.

It having been shown by the record that the decedent could not have inflicted the wound that was found on his person either by pressing the trigger with his finger or his foot and that there were no contrivances found whereby he could have done so, the inference therefrom would be that the injury was not self-inflicted, but was accidental; such being the case, it was properly submitted to the jury, as the jury, and they alone, would have the right to draw the inferences that would flow from such evidence.

> Supreme Lodge K. of P. vs. Beck, 181 U. S. 50, 45 L. Ed. 741.

In the above case, which involved death by gunshot wound, the verdict was rendered for the plaintiff. The question before the court was whether there was sufficient evidence to sustain the verdict. On page 54 of the U. S. Report and page 746 of L. Ed. the court, having under consideration the question as to whether the deceased could have discharged the gun said:

> "There was a dispute as to whether, in view of the length of the gun and the shortness of his arm, he could have reached the trigger without the aid of a pencil or piece of wood, no trace of which was found or indeed looked for. Under those circumstances it is impossible to say that beyond dispute he committed suicide. The discharge of the gun may as well have happened from careless conduct of a drunken man as

from an intentional act. At any rate, the question was one of fact and the jury found that he did not commit suicide and, after its finding has been approved by the trial court and the court of appeals, we are not justified in disturbing it."

In the case of Gamer vs. New York Life Ins. Co., 76 F. (2d) 543, the court, in the course of its opinion, said:

> "The question for our consideration is whether or not the death of insured can be accounted for upon any reasonable hypothesis other than suicide. Conn. Gen. Life Ins. Co. vs. Maher, (C. C. A. 70 F. (2d) 441-445)."

> "In determining whether or not the evidence is sufficient to submit the case to the jury, we must assume the jury will take the view most favorable to the appellant. The evidence as to the means of the death is entirely circumstantial."

After reviewing the evidence, the court concluded that the circumstances where such that the jury should have been left to determine whether or not the death was accidental and reversed the lower court. Upon re-trial judgment was rendered in favor of the plaintiff and affirmed by this court in the case of Gamer vs. N. Y. Life Ins. Co., 90 F. (2d) 817, and was taken to the Supreme court of the United States and reported in the case of New York Life Ins. Co. vs. Gamer 303 U. S. S. Ct. 161, 82 L. Ed. 480-484. In the course of its opinion, the Supreme Court said:

> "The Circuit Court of Appeals has twice held the evidence sufficient to sustain a verdict for plaintiff, and found that the facts brought forward at the second trial are not substantially different from those pre-

> sented on the first appeal. There is no substantial controversy as to the principal evidentiary circumstances, upon which depends decision of controlling issue whether the death of insured was accidental. As we are of the opinion that the trial court erred in giving the challenged instruction, the judgment is therefore reversed; case remanded to district court where another trial may be had. We refrain from discussion of the evidence. We find it is sufficient to sustain a verdict for or against either party. Defendant was not entitled to a mandatory instruction."

THERE WAS NO MOTIVE FOR SELF-DESTRUCTION

It is contended by appellant, at page 17, that motive was not lacking, and in support of such contention it cites only a part of the evidence and draws an unreasonable inference from the fact that the decedent had suffered a stroke and had purchased certain shells on the day of the accident to shoot sparrows. The record discloses that the decedent sustained a stroke on December 14, 1935, about fourteen months prior to the date of his death, which confined him to his bed for about six or seven weeks, and after which he was up and around and continued to improve until the day of his death (p. 75). At the time of his death his physical condition was perfect with the exception of an impediment to his speech and the fact that he couldn't grasp things in his right hand as he did before the stroke (p. 47); that he had recovered to such an extent that he was doing the usual and ordinary things around the farm and home (p. 78), which included his going to the loft of the barn to feed hay long prior to the date of his

death, and that he was very pleased with his recovery (p. 76) and frequently went through movements to show how much stronger and better he was (p. 77), and was of a cheerful disposition, enjoyed his home life with his wife with whom he had been happily married for a long period of time, and was planning things that he was to do in the future on the farm and a trip that was to be taken with his wife (p. 76) ; that on the day of the accident he acted just the same as he always had acted; that his financial condition was good, he didn't owe any debts; that there was nothing unusual about his buying two shells on the date in question as it was his custom and practice, over a period of years, to buy shells in quantities of two, three, and not to exceed five, for the purpose of shooting sparrows; that it was not unusual for him to wait upon himself at the store; that it was his practice to shoot sparrows on the farm and never to keep any shotgun shells around the house. And the evidence discolses that the granary lying underneath the window where the body was found, as well as the loft of the barn, was usually infested with large flocks of birds; that there was grain in the granary which was a lean-to and adjoined right under where the window was located; that he had been left at home alone on different occasions when the shotgun was in the house as well as a twenty-two rifle, one time as long as three days and nights, while he was convalescing and when he was not in as good physical condition as he was at the time of his death. If he had desired to commit suicide on account of his physical condition it is reasonable to infer that he would likely have done so when his wife was away from home in Utah and before he had made such a good

recovery (p. 77). Further, he was capable of handling a gun in December because he killed a stray dog on the premises with the twenty-two. The record further discloses that birds were bothersome because they were shot on the feed yard prior to the date of his death (p. 49); in fact, he had shot birds upon the farm in the winter of 1934 and had done so on their farm at Riverside (p. 76) for a period of years before moving to Blackfoot. The record shows that he was not despondent (p. 54).

In the face of this record, it is submitted that not only was there no reason for his desiring to take his own life, but on the contrary there was every reason why he should desire to live. A significant fact is that when the decedent was going to the barn just before the first shot was fired he was seen by Verna Bowman who was at the chicken coop near the barn, and it is fair to infer that decedent could likewise have seen her. The record shows that it was twenty minutes between the first and second shots and that the shot by which the decedent was killed was the second shot. Isn't it reasonable to infer that if the decedent had intended to commit suicide that he would not have fired a shot at the birds through the window of the barn and waited twenty minutes then to have shot himself, as he knew that the first shot would naturally attract attention. When the first shot was fired birds flew in all directions and it could be reasonably inferred that he was waiting for part of the birds to come back to get into the granary, and, while he was so waiting, the gun was accidentally discharged either by the gun slipping from his hand and the butt striking on the floor with such force or under such conditions that it dis-

charged, or that the mechanism of the gun did not properly function and it was discharged, accidentally killing the decedent.

CASES CITED BY APPELLANT

It will be obesrved from an examination of the cases cited by appellant in support of the proposition that the evidence in the instant case is insufficient to support the verdict only a part of the cases so cited involve death by firearms. In order to show the dissimilarity we will briefly state the facts in such cases.

In the case of Frankel vs. N. Y. Life Ins. Co., 51 Fed. (2d) 933, Frankel was found unconscious on the floor at the rear end of the store with a gunshot wound in his head, which had entered over the left ear and emerged slightly higher on the right side. He was lying in a curved position, a Colt's automatic pistol beside him in a curve near the left hand, and an empty shell from the pistol on the floor at his back. Powder burns were found on the left side of his head indicating the pistol was fired at close range. He was left-handed. To fire the pistol it was necessary to have the side safety down, grip the handle and pull the trigger. The pistol could not be discharged by falling or a blow. The pistol had some blood on it.

Held the only evidence to support the theory of accident consisted of circumstances tending to show the insured had a composed mental attitude and apparently no motive for self-destruction.

It will be observed no evidence was introduced to show that it was impossible for Frankel to shoot himself.

In the case of New York Life Ins. Co. vs. Anderson, 66 Fed. 707, the facts are: Insured was found early in the morning in the basement of the store where he worked, lying somewhat on his right side, with a bullet hole in his right temple about which there were powder burns and singed hair, and a twenty-two rifle with the barrel pointing to the feet by his right side; that the insured was right-handed; had no married or financial troubles but was a heavy drinker and was quarrelsome only when drinking, and had been threatened with discharge the next time he got drunk; that he was drunk the day before and had previously talked of suicide to end his troubles; that the store had not been disturbed; insured's clothes were in order; there was no sign that he had slipped.

The rifle belonged to another employee and was kept at the store.

Held: That the evidence was compatible only with the hypothesis of suicide with rifle. It will be observed that he had talked of suicide and that there was nothing in this case to show the impossibility of committing suicide or any reason why the employee would be in the basement with the twenty-two rifle.

In the case of Fidelity and Casualty Co. of N. Y. vs. Driver, 79 Fed. (2d) 713, insured was killed by a shotgun discharged into his breast while hunting doves. Insurance company claimed suicide; widow alleged accidental death. Held the facts were sufficient to go to the jury and the jury found for the plaintiff. The case was appealed to the Circuit Court. It was reversed on appeal because of a faulty instruction

and *not* because of insufficiency of the evidence. This case instead of being an authority for the appellant in suport of its assignment of error is an authority in support of the appellee's contentions.

In the case of N. Y. Life Ins. Co. vs. Alman, 22 Fed. (2d) 98, the facts briefly are: Dr. Alman was found dead in his bedroom early in the morning. He was lying on his back diagonally across the bed with a gunshot wound about one inch below his left nipple. His left foot was on the floor and his right foot was just about touching the floor. He was in his night shirt, and his double-barrel shotgun with the butt on the floor near the right foot was leaning against the left knee. He had committed an indiscretion with his neighbor's wife a short time before and had been threatened by her husband with exposure. The jury rendered a verdict for the plaintiff and the case was appealed. The court held:

> "On appeal the plaintiff contends that it was showed by circumstances in evidence to be impossible that Dr. Alman could have fired the fatal shot because of the position of the gun, the range and size of the wound, and the lack of powder marks. *It is not denied that he could have reached the trigger either with his hand or foot* (italics ours) ; but it is said that, if he had done either, the gun would not have been between his legs, but would have fallen on the left of his left knee. The reason urged for the conclusion is that the physician who examined the body testified the wound ranged not only upward but towards the right shoulder. Arguments of this kind have very little weight, especially in the absence of reliable examination. No definite conclusion can be safely based upon the superficial examination that was made. But assuming that the wound ranged to the left of its

> entrance such a result could have been produced by placing the butt sidewise on the floor with the left foot on it to hold it in place and the trigger on the right side where the right foot would be. In this way the bend in the stock would throw the muzzle to the left and after being fired it would naturally come to rest between the legs. Dr. Alman, the insured was six feet in height, weighed two hundred pounds; the gun barrel was twenty-eight inches."

It is important to observe that in this case it was not denied that he could have reached the trigger with either his hand or his foot, which is just the opposite in respect to facts in the present case, for the reason it was demonstrated to the jury that it would be impossible for the decedent Bowman in the present case to have reached the trigger with his hand or to have pressed the trigger with his foot, because of the size of the shoes and trigger guard and the further fact there was considerable difference in the size of Dr. Alman and Mr. Bowman, and in the Alman case there was a good motive established why he would want to take his own life, which, of course, is absent in the present case.

In the case of Aetna Life Ins. Co. vs. Tooley, 16 Fed. (2d) 243, the facts are the body of the insured, shot through the temple, was found in a car which he had driven alone from his home and stopped a short distance away but out of sight from it. The bullet was of the caliber of his own revolver, not self-cocking, which lay on the seat and had recently been fired. There were powder burns in and close around the wound. There was no robbery or evidence of a struggle or an accident. He had for some time previously been in ill health, depressed

and despondent, though his business was prosperous and his home life pleasant. There was no evidence that it was impossible for the deceased to take his own life.

In the case of N. Y. Life Ins. Co. vs. Trimble, 69 Fed. (2d) 849, the facts briefly are that insured, who was right-handed, was found, shot through the head from the right to left, with powder burns on the right temple and an automatic pistol gripped in his right hand; that the forefinger was not resting on the trigger, but that all four fingers were clasped around the handle; that the clip or magazine of the pistol was on the bed about eighteen inches away from the right side of and between the body and the foot of the bed; that the clip could not be released from the pistol with the forefinger while one had a firm grip on the handle; that two days before the fifteenth of the month and on the day of his death insured sent in his semi-monthly statement of his salary and remained at the office after his co-workers had left for the day, which was the last time he was seen alive; that there were no signs of struggle, nor had any of his personal effects been interfered with or taken away. It is very apparent that the facts in this case do not resemble in any way the facts as disclosed by the record in the present case.

In the case of Sugar vs. Industrial Commission of Utah, 75 Pac. (2d) 311, the facts briefly are that the decedent was found in a store in which he worked, shot through the heart. His body was found on the floor behind a counter by persons later entering the store. A .38 revolver was found on the counter at or near where he fell. An empty shell therein cor-

responded with the ball taken from his body. Powder burns were found on the clothing of the deceased and a powder burn on the counter at or near where the gun was lying. One of the deceased's pockets was pulled inside out when he was found. The cash register drawer was about half an inch open. The drawers in the safe were partly pulled out. On the floor beside him was found his wallet and two black tin cash boxes, opened or partly opened, and appearing to have been gone through. There were some insurance policies in one of the boxes and papers standing up in the drawers that were pulled out. There was evidence that the deceased's life was heavily insured, to a total of $43,000, over half of which was procured within a few months before his death, and $20,000 additional insurance had been recently applied for and refused by the insurance company. The Industrial Commission found from all the evidence that the death was by suicide rather than by accident. Appeal was taken to the Supreme Court. Held:

> "We think there is sufficient evidence to sustain the findings made by the commission. Certainly, it does not compel the opposite theory as matter of law. Granting that there is some evidence or inference favoring the applicant's theory, yet the commission was not bound to adopt that theory. It was the commission's duty to decide between the opposing theories and inferences.
>
> "Whether Industrial Commission should have in law arrived at conclusion of fact different from that at which it did arrive from the evidence, presents question of law reviewable by Supreme Court only when it is claimed that commission could only arrive

at one conclusion from the evidence, and that it found contrary to the inevitable conclusion.

"At bar that is the very question in dispute and found against by the commission."

'hat there were two conflicting theories and inferences that ould be drawn from the evidence and the commission was t liberty to draw whichever conclusion or inference they hought proper.

It is clear that the foregoing case not only does not support e contention of appellant in this case but is directly in point o far as the position of appellee is concerned because of the act that the only thing that the court decided in the Utah case as that there was ample evidence to justify the finding that e Industrial Accident Commission made and for that reason e order of the commission was affirmed.

In the case of Aetna Life Ins. Co. vs. Alsobrook, 299 . W. 743, the facts briefly are: In action on life insurance olicy evidence showing that barrel of shot gun must have een in insured's mouth at time it was fired; his face was loody and a Mr. Lee who discovered him, did not at first ecognize him although well acquainted with him. He made n examination and found that Alsobrook was shot in the outh, the shot ranging from roof toward the back of head, ithout any visible wounds or powder burns on the outside f his face anywhere. The skull had been torn to pieces by e shot; the back of his head being mushy and soft; that e skin on the outside of the head was not broken, none of e shot passing through the head to the outside. He was shot

with a double-barrel shotgun, the right-hand barrel having been fired, the other barrel being cocked.

In the case of Fidelity Mutual Life Ins. Co. vs. Wilson, 2 S. W. (2d) 80, the facts briefly are: That insured was wounded in the mouth with a revolver and he was found in a locked hotel room; that the shooting occurred subsequent to a period of treatment at hospital for excessive drinking; that he was badly involved financially. By no stretch of the imagination can we see how this case serves any helpful purpose and clearly does not support the assignments of error made in the present case for the reason of the marked dissimilarity in the facts.

In the case of Burkett vs. New York Life Ins. Co., 56 F. (2d) 105, the evidence as stated in the case was:

> The insured's body was found lying across the cement pavement about three and a half feet from the door through which he had gone in leaving the store. The top of his head from just above his right ear was blown off. Blood and some of his brains were found on the roof, which was about eight feet high. The gun was lying on the walk about three feet from deceased's body; the butt being towards the body. It contained an exploded shell in the right-hand barrel. The shell was of a kind kept in the store for sale. The gun was a cheap one. To shoot it the hammer had to be cocked and the trigger pulled. It was usual for Mr. Jennings to keep it unloaded. He stated that he thought it was not loaded. In the rear of the store next to the concrete walk was a small open space and beyond that thick bushes and trees. Several witnesses testified that there were powder burns on the face of the deceased near the part that was blown off, and that there was a ring on the face like the mark of a gun barrel. Other

> witnesses, including the undertaker who prepared the body for burial, testified that they did not see powder burns or the mark of a gun barrel on his face. The undertaker said, "There might have been some there I did not see." A gun would have to be very close, less than one foot, to one's face when fired to make powder burns on the skin. A man of the height of the insured, about five feet and seven inches, could fire the gun while in a standing position, the muzzle being so placed with reference to his person that the shot would produce the results shown by the evidence.

It will be observed that there was testimony in the case hat the insured could fire the gun while in a standing position, he muzzle being placed with reference to his person that the hot would produce the result shown by the evidence. It will e noted also that the wound inflicted was above the right ar, which would be at least six inches above the point of the hin, where the evidence showed the load entered the face of he decedent in the instant case, and a greater distance above he holes in the jumper.

In view of the fact that the other cases cited by appellant o not involve firearms and are based upon facts so entirely ifferent from the facts in this record, it is thought that it vill not aid the court to make an analysis of such cases herein.

Inasmuch as the appellant has only submitted argument in ipport of assignment six and adopts such argument in support of its contention that the court erred as set forth in the ther assignments, we will adopt the argument made herein ı answer to all appellant's assignments of error.

In conclusion it is submitted that the evidence in this case and the reasonable inferences to be drawn therefrom were amply sufficient to support the verdict, and that the court did not err in denying appellant's motion for nonsuit and directed verdict. It is further submitted that the said verdict is not contrary to the evidence and the judgment entered thereon is not contrary to law, and that the court did not err in denying the motion for a new trial, and that accordingly the judgment entered herein should be affirmed.

Respectfully submitted,

T. D. Jones

C. W. Pomeroy

Ralph H. Jones

Attorneys for Appellee

No.

In the United States
Circuit Court of Appeals
For the Ninth Circuit.

HERBERT P. SEARS, Trustee of the Estate of Globe Drug Company, Inc., Bankrupt,

Complainant,

vs.

LEW O. STELZNER and T. E. KLIPSTEIN,

Defendants.

T. E. KLIPSTEIN,

Appellant,

vs.

HERBERT P. SEARS, Trustee in Bankruptcy of the Estate of Globe Drug Company, Inc.,

Appellee.

Transcript of Record

Upon Appeal from the District Court of the United States for the Southern District of California, Northern Division.

FILED

Parker & Baird Company, Law Printers, Los Angeles.

No.

In the United States
Circuit Court of Appeals
For the Ninth Circuit.

HERBERT P. SEARS, Trustee of the Estate of Globe Drug Company, Inc., Bankrupt,

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vs.

LEW O. STELZNER and T. E. KLIPSTEIN,

Defendants.

T. E. KLIPSTEIN,

Appellant,

vs.

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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San Francisco, California.

IN THE DISTRICT COURT OF THE UNITED STATES, IN AND FOR THE SOUTHERN DISTRICT OF CALIFORNIA, NORTHERN DIVISION

—ooOoo—

HERBERT P. SEARS, Trustee of the Estate of Globe Drug Company, Inc., Bankrupt,	
Complainant,	No. E-4
vs.	In Equity
LEW O. STELZNER and T. E. KILPSTEIN,	CITATION
Defendants.	

THE PRESIDENT OF THE UNITED STATES:

To HERBERT P. SEARS, Trustee in Bankruptcy of the Estate of Globe Drug Company, Inc., Greetings:

You are hereby cited and admonished to be and appear in the United States Circuit Court of Appeals for the Ninth Circuit, in the City of San Francisco, State of California, thirty days from and after the date of this citation, pursuant to an appeal allowed and filed in the office of the Clerk of the District Court of the United States for the Southern District of California, from a decree in said cause, filed and entered on the 29th day of December, 1937, as modified and amended by an order of said Court made and entered the 2nd day of April,

1938, wherein T. E. Klipstein is appellant and you are appellee, to show cause, if any there be, why the decree rendered against said appellant as in said appeal mentioned should not be corrected, and why speedy justice should not be done the parties in that behalf.

WITNESS, THE HONORABLE LEON R. YANKWICH, JUDGE OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF CALIFORNIA, this 25th day of April, 1938.

Leon R. Yankwich

Judge of the United States District Court for the Southern District of California

Due, personal service of the within citation, by copy, is hereby admitted this 29th day of April, 1938.

A. L. Shannon

C. A. Shuey

Attorneys for Appellee

Due, personal service of the appellant T. E. Klipstein's assignment of errors heretofore filed in the above action, by copy, is hereby admitted this 29th day of April, 1938.

A. L. Shannon

C. A. Shuey

Attorneys for Appellee

[Endorsed]: Filed May 3, 1938. R. S. Zimmerman, Clerk By Edmund L. Smith, Deputy Clerk.

[TITLE OF DISTRICT COURT AND CAUSE.]

STIPULATION FOR FILING OF AMENDED BILL OF COMPLAINT

IT IS HEREBY STIPULATED by and between the above named complainant and the above named defendant, T. E. Klipstein, that the foregoing Amended Bill of Complaint attached hereto may be filed herein as of course; and it is further stipulated that the Answer to the original Bill of Complaint heretofore filed herein by said defendant, T. E. Klipstein, be considered in all respects as his Answer to said Amended Bill of Complaint; it being expressly understood by and between the parties to this stipulation that the said defendant, T. E. Klipstein, reserves the right to assert each and every defense available to him under his Answer as originally filed, and any and all objections to the legal sufficiency of said Bill of Complaint, and is not to be deemed to have waived any such matter of defense hereby.

Dated: December 18, 1936.

Clarence A. Shuey
Arthur L. Shannon
Attorneys for Complainant

HOMER JOHNSTONE and
SIDNEY H. WYSE
By Homer Johnstone
Attorneys for Defendant T. E. Klipstein

[Endorsed]: Filed Dec. 24, 1936. R. S. Zimmerman, Clerk By L. B. Figg, Deputy Clerk.

IN THE DISTRICT COURT OF THE UNITED STATES, IN AND FOR THE SOUTHERN DISTRICT OF CALIFORNIA, NORTHERN DIVISION

—ooOoo—

HERBERT P. SEARS, Trustee of the Estate of Globe Drug Company, Inc., Bankrupt,	)	No. E 4
Complainant,	)	IN EQUITY
vs.	)	AMENDED BILL OF COMPLAINT
LEW O. STELZNER and T. E. KLIPSTEIN,	)	
Defendants.	)	

—ooOoo—

TO THE HONORABLE DISTRICT COURT OF THE UNITED STATES, IN AND FOR THE NORTHERN DIVISION OF THE SOUTHERN DISTRICT OF CALIFORNIA:

Now comes the above named complainant and files herein his amended bill of complaint of course as follows, to wit:

I.

In or about the month of April, 1936, Globe Drug Company, Inc., was adjudicated a bankrupt by an order duly made and entered by the above entitled court, and thereafter, on April 18, 1936, by proceedings duly had in the administration of said bankrupt's estate, plaintiff was appointed as trustee of said estate, thereupon duly quali-

fied as such, and ever since has been and now is the duly appointed, qualified, and acting trustee of the estate of said bankrupt.

II.

At all times herein mentioned said Globe Drug Company, Inc. was a corporation duly organized and existing under and by virtue of the laws of the State of California; at all of such times Lew O. Stelzner was a stockholder, the president, and one of the members of the board of directors of said corporation, and T. E. Klipstein was a stockholder, the vice-president, and one of the members of the board of directors of said corporation.

III.

In about the year 1928 the defendants Lew O. Stelzner and T. E. Klipstein borrowed the sum of $17,000.00 from the Bank of America, and in consideration of such loan executed to such bank their personal joint and several promissory note for the same; said sum of $17,000.00 was thereupon used by said defendants for the purpose of purchasing certain issued and outstanding shares of the Globe Drug Company, Inc., for their own personal and individual account.

IV.

During the period of time from the execution of said note up to October 19, 1935, various payments were made on account of the principal and interest of said note, aggregating a sum in excess of $12,200.00; all such payments were made by, and directly from and with the funds of, said corporation; at all of the times when said payments were made as aforesaid, said corporation owed various sums of money to various creditors, and was in

an insolvent condition; no consideration whatever was ever received by said corporation for or in connection with said payments; said payments were made as aforesaid with the purpose and intent on the part of said corporation, and of said defendants, of hindering, delaying, and defrauding said creditors; complainant does not know the true aggregate amount of the sums so paid out as aforesaid, and it is therefore necessary that defendants render to this court a true and accurate account thereof.

V.

On or about October 19, 1935, there remained unpaid on said promissory note a balance of $4,800.00; on or about said date defendants, acting as directors and officers of said corporation, caused to be executed to said Bank of America the promissory note of said corporation in the sum of $4,800.00; said note was thereupon accepted by said bank in payment of the balance due on said promissory note of the defendants; said corporation received no consideration for the execution of the said note, either directly or indirectly.

VI.

Shortly after the execution of said last mentioned promissory note, the defendant Klipstein purchased the same from said bank and thereupon, and on October 19, 1935, commenced an action in the Superior Court of the State of California, in and for the County of Kern, to recover from said corporation the amount alleged by him to have been so paid in the purchase of said note; thereafter the defendants fraudulently permitted said corporation to suffer a default judgment to be entered in said action against it for the sum of $5,364.00; thereafter execution was issued on said judgment, pursuant to which

all of the properties and assets of said corporation were sold at public auction by the sheriff of said county. On information and belief, plaintiff alleges that the value of said property so sold upon execution was the sum of $5,000.00.

VII.

At the time said action was commenced and said execution sale was effected as aforesaid, said corporation owed various sums of money to various creditors, and was insolvent; said defendants, acting in concert and conspiracy with one another, caused said action to be commenced and said execution sale to be effected, with the purpose and intent of hindering, delaying, and defrauding the creditors of said corporation.

VIII.

The above mentioned creditors of said corporation have duly proved their claims in said bankruptcy proceedings; there are not sufficient assets in the bankrupt's estate with which to pay such claims in full, and unless said payments made by said corporation, and said property, or its value, are restored to the bankrupt's estate, the claims of said creditors will remain unsatisfied.

For a separate, further, and second cause of action, complainant alleges that:

I.

All of the allegations and statements set forth in paragraphs I, II and III of the foregoing first cause of action are hereby incorporated in this second cause of action as if fully set forth herein.

II.

Within three years immediately prior to plaintiff's appointment and qualification as such trustee as aforesaid, various payments were made on account of the principal and interest of said note, aggregating the sum of $5,-132.71; all of such payments were made with funds withdrawn from the assets of said corporation at the willful instigation, authorization, and direction of said defendants, acting as officers and directors of said corporation, and while they were stockholders thereof; at said times said corporation had no surplus or net profits of any kind out of which to pay dividends on its shares, nor was said corporation then in the process of winding up or dissolution; nor were said withdrawals made upon the vote, or written consent of the holders of any of the shares of said corporation other than the shares then held by the defendants, nor did the Commissioner of Corporations of the State of California ever issue any permit authorizing such withdrawals; therefore, the withdrawals of the funds and assets of said corporation as aforesaid were in violation of Section 363 of the Civil Code of the State of California, and of Section 309 of said code as it existed prior to the adoption of said Section 363; at all of the times when said funds and assets were withdrawn as aforesaid, said corporation owed to various creditors sums of money which, as plaintiff is informed and believes, aggregated in excess of the aggregate of the sums so withdrawn as aforesaid.

III.

The above mentioned creditors of said corporation have duly proved their claims in said bankruptcy proceedings; there are not sufficient assets in the bankrupt's estate with which to pay such claims in full, and unless said payments and withdrawals are restored to the bankrupt's estate, the claims of said creditors will remain unsatisfied.

IN CONSIDERATION WHEREOF, and inasmuch as complainant is remediless, according to the strict rule of common law, and can only have relief in a court of equity where matters of this nature are cognizable, said complainant prays that said defendants, and each of them, be required, according to his best and utmost knowledge, remembrance, information, and belief, to make a full, true, and correct answer to this amended bill of complaint, but not under oath, or affirmation, the benefit of which is hereby expressly waived; that this court direct said defendants to render herein a true and accurate account of the sums of money paid out and withdrawn as hereinbefore alleged; and that this court render a decree against said defendants, and each of them, for such sums of money and the value of such property as is found to have been paid out by, and taken or withdrawn from, the bankrupt corporation as aforesaid, and for such other and further relief as to the court may seem meet and proper.

Clarence A. Shuey
Arthur L. Shannon
Attorneys for Complainant

[Endorsed]: Filed Dec. 24, 1936. R. S. Zimmerman, Clerk By L. B. Figg, Deputy Clerk.

[Title of District Court and Cause.]

ANSWER

Comes now T. E. Klipstein, one of the defendants in the above-entitled action, and in answer to plaintiff's bill of complaint on file herein, and in his own behalf and not for any other defendant, admits, denies and alleges as follows:

I.

Admits the allegations of paragraph I of plaintiff's bill of complaint.

II.

Denies each and every allegation of paragraph II of plaintiff's bill of complaint, except that defendant admits that, at all times therein mentioned, the Globe Drug Company, Inc., was a corporation duly organized and existing under and by virtue of the Laws of the State of California.

III.

Denies each and every allegation of paragraph III of plaintiff's bill of complaint, except that defendant admits that on or about the 3rd day of January, 1928, Lew O. Stelzner borrowed the sum of $17,000.00 from the Bank of America, or its predecessor bank at Bakersfield, California; that in consideration for said loan said Lew O. Stelzner executed his promissory note to said bank; that defendant affixed his signature on and to the said note; but in this connection defendant alleges that he received no consideration of any description at the time of the signing of said note or at any time thereafter, and that no consideration whatever passed to this defendant for his said signature.

IV.

Denies each and every allegation of paragraph IV of plaintiff's bill of complaint, except that defendant admits that certain payments were made on the said note; the amount and extent and dates of such payments being unknown to this defendant.

V.

Denies each and every allegation of paragraph V of plaintiff's bill of complaint, except that defendant admits that on or about the 19th day of October, 1935, there was a balance unpaid on the said promissory note, the exact amount thereof being unknown to defendant; and defendant further admits that the Bank of America received a note from said corporation on or about said date.

VI.

Denies each and every allegation of paragraph VI of plaintiff's bill of complaint, except that defendant admits that on or about the 19th day of October, 1935, an action was filed by him in the Superior Court of the State of California, in and for the County of Kern, against the said corporation.

VII.

Denies each and every allegation of paragraph VII of plaintiff's bill of complaint.

VIII.

Alleges that he has no knowledge or information sufficient to form a belief as to the truth of the allegations of paragraph VIII of plaintiff's bill of complaint, and

placing his denial on that ground denies each and every allegation of said paragraph.

IX.

Answering paragraph I of plaintiff's second cause of action, defendant hereby refers to and incorporates herein as if fully set out hereinafter, all of paragraphs I, II and III of this answer.

X.

Denies each and every allegation of paragraph II of plaintiff's second cause of action contained in plaintiff's said bill of complaint.

XI.

Alleges that he has no knowledge or information sufficient to form a belief as to the truth of the allegations of paragraph III of plaintiff's second cause of action, and placing his denial on that ground denies each and every allegation of said paragraph.

AS A FURTHER SEPARATE AND DISTINCT DEFENSE TO PLAINTIFF'S BILL OF COMPLAINT, Defendant alleges:

I.

That the plaintiff is estopped from, and should not be permitted to say that this defendant is liable for any withdrawals from the funds of said Globe Drug Company, Inc., for the reason that any and all transaction or transactions by and between this defendant and the said alleged bankrupt were initiated and maintained at the solicitation

of the said bankrupt and for the purpose of enabling it to carry on its business affairs, and in order to procure funds with which to protect and save its creditors from imminent loss and losses with which they were confronted at the time of the aforementioned transactions, and that the said creditors received all the benefits thereof; that this defendant received no consideration or benefit or benefits whatsoever from any of such transactions, but in fact sustained personally heavy monetary losses by reason thereof.

AS A FURTHER SEPARATE AND DISTINCT DEFENSE TO PLAINTIFF'S BILL OF COMPLAINT, Defendant alleges:

I.

That as to any withdrawals of funds from the Globe Drug Company, Inc., alleged to have been made more than three years prior to the commencement of this action plaintiff's cause of action is barred by the California Code of Civil Procedure, Section 338, subdivisions (1) and (4) thereof.

WHEREFORE, defendant prays that plaintiff take nothing by his bill of complaint, and that defendant recover his costs of suit incurred herein.

Homer Johnstone

Attorney for Defendant T. E. Klipstein.

936 A. G. Bartlett Bldg.
Los Angeles, California.

STATE OF CALIFORNIA)
) ss.
COUNTY OF KERN)

T. E. KLIPSTEIN, being first duly sworn deposes and says: That he is one of the defendants in the foregoing and above entitled action; that he has read the within Answer and knows the contents thereof; and that the same is true of his own knowledge except as to the matters which are herein stated on his information or belief, and as to those matters he believes it to be true.

T. E. Klipstein

Subscribed and Sworn to before me this 6th day of December, 1936

[Seal] Cara Pfuhl

Notary Public in and for said County and State

[Endorsed]: Filed Dec. 7, 1936. R. S. Zimmerman, Clerk By L. B. Figg, Deputy Clerk.

[Title of District Court and Cause.]

ANSWER OF DEFENDANT LEW O. STELZNER

Comes now LEW O. STELZNER, one of the defendants in the above entitled action, and in answer to the bill of complaint on file herein, and in his own behalf and not for any other defendant, admits, denies and alleges as follows, to-wit:

I.

Admits the allegations of Paragraph I of the said bill of complaint.

II.

Denies generally and specifically, each and every allegation contained in Paragraph II of said bill of complaint, except that defendant admits that at all times therein mentioned the Globe Drug Company, Inc., was a corporation duly organized and existing under and by virtue of the laws of the State of California.

III.

Denies generally and specifically, each and every allegation contained in Paragraph III of said bill of complaint, except that defendant admits that on or about the 3rd day of January, 1928, defendant borrowed from the Bank of America the sum of $16,000.00 and executed his promissory note to said bank for said sum; that T. E. Klipstein endorsed said note for the accommodation of defendant; that defendant used the proceeds of the said loan for the purchase of stock of the Globe Drug Company, Inc., and caused the said stock to be issued to the said T. E. Klipstein as security for said endorsement.

IV.

Denies generally and specifically, each and every allegation contained in Paragraph IV of said bill of complaint, except that defendant admits that during the period from the execution of said note up to October 19th, 1935, or thereabouts, various payments were made on account of said note, and that all of such payments were made with the funds of the said corporation, but defendant alleges that all of said payments were made out of the surplus profits of said corporation.

V.

Denies generally and specifically, each and every allegation contained in Paragraph V of said bill of complaint, except that defendant admits that on or about the 19th day of October, 1935, there remained unpaid on said promissory note a balance of $4800.00, and that on or about the said date the said corporation executed to the Bank of America its promissory note in the sum of $4800.00.

VI.

Denies generally and specifically, each and every allegation contained in Paragraph VI of said bill of complaint, except that defendant admits that on or about the 19th day of October, 1935, the defendant Klipstein purchased the said note from the Bank of America and commenced an action in the Superior Court of the State of California, in and for the County of Kern, against said corporation upon the said note executed by said corporation; that judgment in said action was rendered in favor of this answering defendant in the sum of $5364.00, or thereabouts, and execution thereon issued; that pursuant to said execution a certain stock of goods belonging to the said corporation was sold by the sheriff at public auction,

and that the reasonable value of the said stock of goods was the sum of $1900.00.

VII.

Denies generally and specifically, each and every allegation contained in Paragraph VII of said bill of complaint.

VIII.

This defendant has no knowledge or information sufficient to form a belief as to the truth of the allegations of Paragraph VIII of the said bill of complaint, and placing his denial upon that ground, denies generally and specifically, each and every allegation of said paragraph.

IX.

Answering paragraph I of complainant's second cause of action, defendant hereby refers to and incorporates herein as if fully set out hereinafter all of paragraphs I, II and III of this answer.

X.

Denies generally and specifically, each and every allegation contained in Paragraph II of the second cause of action contained in said bill of complaint.

XI.

This defendant has no knowledge or information sufficient to form a belief as to the truth of the allegations of Paragraph III of the second cause of action contained in said bill of complaint, and placing his denial upon that ground, denies generally and specifically, each and every allegation of said paragraph.

As a FURTHER AND SEPARATE DEFENSE to said bill of complaint, defendant alleges that the causes of action alleged therein are, and each of them is, barred by the provisions of Subdivisions 1 and 4 of Section 338 of the Code of Civil Procedure of the State of California.

As a FURTHER AND SEPARATE DEFENSE to said bill of complaint, defendant alleges that the above entitled court has no jurisdiction of the subject matter of this action.

WHEREFORE, defendant prays that complainant take nothing by his bill of complaint, and that defendant recover his costs of suit incurred herein.

David E. Peckinpah
Attorney for Defendant, LEW O. STELZNER.

STATE OF CALIFORNIA)
) ss.
COUNTY OF FRESNO.)

DAVID E. PECKINPAH, being first duly sworn, deposes and says: That he is the attorney for the defendant, LEW O. STELZNER, in the above entitled action; that said defendant is absent from the County of Fresno where his attorney has his office and for that reason affiant makes this verification; that affiant has read the foregoing Answer and knows the contents thereof; that the same is true of his own knowledge, except as to the matters as are therein stated on his information and belief, and as to those matters that he believes it to be true.

David E. Peckinpah

Subscribed and sworn to before me, this 9th day of June, 1937.

[Seal] June Johnson
NOTARY PUBLIC in and for the County of Fresno, State of California.

[Endorsed]: Filed Jun. 11, 1937. R. S. Zimmerman, Clerk By L. B. Figg, Deputy Clerk.

[Title of District Court and Cause.]

STIPULATION TO SET FOR TRIAL

IT IS HEREBY STIPULATED by and between the respective parties hereto that the above entitled action may be set down for trial on any date convenient to the court during the term commencing on the first Monday in October, 1937.

IT IS FURTHER STIPULATED that a jury for the trial of such action is hereby waived.

Dated: July 7, 1937.

Clarence A. Shuey
Arthur L. Shannon
Attorneys for Complainant

David E. Peckinpah
Attorney for Defendant
Lew O. Stelzner

Homer Johnstone
Attorney for Defendant
T. E. Klipstein

[Endorsed]: Filed Aug. 4, 1937. R. S. Zimmerman, Clerk By Edmund L. Smith, Deputy Clerk.

[Title of District Court and Cause.]

AMENDMENT TO THE ANSWER OF THE DEFENDANT T. E. KLIPSTEIN

Comes now the defendant T. E. Kilpstein, and by leave of Court pursuant to the written stipulation of the plaintiff on file herein, files this amendment to the answer of said defendant to complainants Bill of Complaint, (which by the terms of said stipulation was extended to and deemed to be the answer of said defendant to Complainants Amended Complaint), and by way of such amended answer admits, denies and alleges as follows:

1.

Denies each and every allegation of paragraph *11* of plaintiffs amended Bill of Complaint, except that defendant admits that Articles of Incorporation were filed with the Secretary of State of the State of California on the 17th day of July, 1920.

Defendant further alleges that no other or further steps of any kind were ever taken to complete the organization of said Corporation; that no stock was ever issued by said corporation; that no bylaws were ever adopted by said corporation; and, that the persons who executed the said articles and caused the same to be filed as aforesaid thereupon became the Directors of said Corporation and still are such directors thereof.

11

Except as to foregoing amendment to paragraph *11* of this defendants answer as originally filed herein defendant hereby adopts and re-states herein to the same extent as if fully set out hereinafter each and all of the respective recitals, allegations and paragraphs of said answer to be deemed to be and considered as the answer of this defendant to Complainants amended Bill of Complaint herein.

WHEREFORE, defendant prays that complainant take nothing by his Bill of Complaint herein, and that defendant recover his costs of suit incurred herein.

Homer Johnstone
S. H. Wyse
Attorneys for defendant T. E. Klipstein

801 Bartlett Bldg
Los Angeles, Calif

[Endorsed]: Filed October 27, 1937. R. S. Zimmerman, Clerk By Louis J. Somers, deputy.

[Title of District Court and Cause.]

TRIAL BRIEF OF DEFENDANT KLIPSTEIN
SUMMARY OF POINTS DISCUSSED

I. There was a complete failure of proof necessary to entitle complainant to a recovery against defendant Klipstein.

* * * * * * * *

C. There was no proof that defendant Klipstein received anything by reason of any transaction in question, and in fact the proof showed affirmatively that he was the loser by such transactions of more than $5,000.00.

D. There was no proof that defendant Klipstein was a de jure director of the bankrupt, and there was insufficient proof to hold him as a de facto director.

* * * * * * * *

IV. Complainant is estopped from asserting that defendant Klipstein is liable on the causes of action stated.

* * * * * * * *

Defendant Klipstein therefore asks this Court to declare by its judgment that neither in equity or law has the complainant the right to recover any part of the moneys by him claimed.

Respectfully submitted,

Homer Johnstone
Sidney H. Wyse.
Attorneys for defendant Klipstein.

[Endorsed]: Filed Nov. 13, 1937. R. S. Zimmerman, Clerk By Louis J. Somers, Deputy Clerk.

At a stated term, to-wit: The April Term, A. D. 1937, of the District Court of the United States of America, within and for the Northern Division of the Southern District of California, held at the Court Room thereof, in the City of Fresno on Saturday the 4th day of December in the year of our Lord one thousand nine hundred and thirty-seven.

Present:

The Honorable: Leon R. Yankwich District Judge.

HERBERT P. SEARS,)
)
Plaintiff,)
)
vs.) No. E-4
)
LEW O. STELZNER, et al)
)
Defendants.)

This cause having been heard upon the issues raised by the Bill of Complaint and the Answer, and evidence oral and documentary having been introduced, and the cause having been submitted to the Court for decision, and the Court having considered the evidence and the law and the arguments and briefs of counsel, now finds in favor of the plaintiff and (upon the authority of In re Wright Motor Company (C. C. A. 9, 1924) 299 Fed 106) orders a decree entered ordering and decreeing that plaintiff do have and recover from the defendants Lew O. Stelzner and T. E. Klipstein and each of them, the

sum of $4255.54 and acrued interest, the same being the sums shown to have been illegally withdrawn and paid out by the defendants and for which they are liable to account to the plaintiff.

The Court finds that there is undisputed proof in the record as to the amounts withdrawn and that therefore an accounting is not necessary.

Decree is to provide that the recovery of the full amount named and accrued interest shall be contingent upon the needs for funds to satisfy the claims against the estate and recovery shall be had in full only if the above amount when added to the cash now in the hands of the trustee is needed to satisfy all the debts of the estate. Otherwise recovery to be reduced proportionately and surplus be returned to the defendants.

Findings and decree to be prepared by plaintiff under Rule 44.

Exception to the defendants.

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This cause came on regularly for trial before the above entitled Court, sitting without a jury, plaintiff appearing by his counsel, Arthur L. Shannon and Clarence A. Shuey, defendant Lew O. Stelzner appearing by his counsel, David E. Peckinpah and L. N. Barber, and defendant T. E. Klipstein appearing by his counsel, Homer Johnstone and S. H. Wyse; and evidence both oral and documentary having been introduced and received, and the Court having considered the evidence and the law and the arguments and briefs of respective counsel, the Court now makes its Findings of Fact and Conclusions of Law as follows, to wit:

FINDINGS OF FACT

I.

That on March 6, 1936, Globe Drug Company, Inc. was adjudicated a bankrupt by an order duly made and entered by the above entitled Court, and thereafter, on April 18, 1936, by proceedings duly had in the administration of said bankrupt's estate, plaintiff was appointed as trustee of said estate, thereupon duly qualified as such, and ever since has been and now is the duly appointed, qualified, and acting trustee of the estate of said bankrupt.

II.

That at all times herein mentioned said Globe Drug Company, Inc. was a corporation duly organized and existing under and by virtue of the laws of the State of California; that ever since January 3, 1928, the defendant Lew O. Stelzner was a stockholder, the president, and

one of the members of the Board of Directors of said corporation, and the defendant T. E. Klipstein was a stockholder, the secretary, and one of the members of the Board of Directors of said corporation.

III.

That on January 3, 1928, the defendants Lew O. Stelzner and T. E. Klipstein borrowed the sum of $17,000.00 from the Bank of America, and in consideration of such loan executed to such bank their personal joint and several promissory note for the same; that said sum of $17,000.00 was thereupon used by said defendants for the purpose of purchasing certain issued and outstanding shares of said Globe Drug Company, Inc., for their own personal and individual accounts.

IV.

That during the period of time from the execution of said note up to October 19, 1935, various payments were made on account of the principal and interest of said note, aggregating a sum in excess of $12,200.00; that all of such payments were made by, and directly from and with the funds of, said corporation; that at each and all of the times when said payments were made as aforesaid, said corporation owed various sums of money to various creditors, such indebtedness at such times being in excess of the amounts of such respective payments; that no consideration whatever was ever received by said corporation for or in connection with any of said payments; that for a period of at least three years prior to the date of its adjudication in bankruptcy, said corporation was in an insolvent condition; that the payments made by said corporation on the personal note of said defendants during said three-year period aggregated a sum of at least

$4,255.54; that each and all of said payments were made as aforesaid with the purpose and intent on the part of said corporation, and of said defendants, of hindering, delaying, and defrauding the creditors of said corporation.

V.

That on or about October 19, 1935, there remained unpaid on the principal of said promissory note a balance of $4,800.00; that on or about said date defendants, acting as directors and officers of said corporation, caused to be executed to said Bank of America the promissory note of said corporation in said sum of $4,800.00; that said note was thereupon accepted by said bank in payment of the balance due on said promissory note of the defendants; that said corporation received no consideration for the execution of said note, either directly or indirectly.

VI.

That shortly after the execution of said last mentioned promissory note, the defendant Klipstein purchased the same from said bank and thereupon, and on October 19, 1935, commenced an action in the Superior Court of the State of California, in and for the County of Kern, to recover from said corporation the amount alleged by him to have been so paid in the purchase of said note; that
illegally and without right or cause [L.R.Y.. J.]
thereafter the defendants, ~~fraudulently~~ permitted said corporation to suffer a default judgment to be entered in said action against it for the sum of $5,364.00; that thereafter execution was issued on said judgment, pursuant to which all of the properties and assets of said corporation were sold at public auction by the sheriff of said county.

VII.

That at the time said action was commenced and said execution sale was effected as aforesaid, said corporation owed various sums of money to various creditors and was insolvent, and said action was commenced and prosecuted, such judgment was suffered to be taken, and said execution sale effected with the purpose and intent on the part of said corporation and the defendants of hindering, delaying, and defrauding the creditors of said corporation.

VIII.

That the payments made out of said corporation's funds as aforesaid, were authorized and consented to by the defendants while acting as officers and directors of said corporation, and while they were stockholders thereof; that said payments were not made out of surplus or net profits of said corporation, nor was said corporation then in the process of winding up or dissolution; that said payments were made without the vote or written consent of any of the shares of said corporation other than the shares held by the defendants; that no permit of the Commissioner of Corporations of the State of California was ever applied for or issued authorizing such payments.

IX.

That this action is not barred by any statute of limitations of the State of California, or otherwise; nor is plaintiff chargeable with any laches in the commencement and maintenance of this action; nor is plaintiff estopped from commencing and maintaining this action.

X.

That this Court has jurisdiction over this action.

CONCLUSIONS OF LAW

From the foregoing facts the Court concludes as follows, to wit:

I.

That all the payments made out of said corporation's funds as above described, were wrongfully and illegally made, and were and are fraudulent in law and void as to plaintiff.

II.

That defendants shall pay to plaintiff, as trustee in bankruptcy of said corporation, such sum of money which, together with the present assets of the estate of said bankrupt, will suffice to satisfy all just and proper claims and reasonable allowances and expenses in such bankruptcy proceedings, which amount is tentatively estimated at the sum of $4,500.00.

III.

That as soon as may be after the payment by defendants of said sum of $4,500.00 and plaintiff's costs herein, a report shall be filed in this proceeding by the Referee in Bankruptcy, showing the exact amount necessary to satisfy all just and proper claims and reasonable allowances and expenses in the said bankruptcy proceedings, and plaintiff shall thereupon have and recover of and from the defendants, and each of them, the amount, if any, shown by such report to be yet necessary to satisfy all just and proper claims and reasonable allowances and expenses in said bankruptcy proceedings, and plaintiff shall be entitled to have execution therefor; that if such report shows that there is a balance remaining out of said sum of $4,500.00, after paying all just and proper claims

and reasonable allowances and expenses in said bankruptcy proceedings, the excess thereof, if any, is to be paid to said defendants.

IV.

That plaintiff shall have and recover from defendants his costs herein.

Let a decree be made and entered accordingly.

To all of which said defendants, and each of them, except, and exception allowed.

Dated: December 29, 1937.

Leon R. Yankwich
United States District Judge

Not approved as to form; Decree does not correctly state matters previously determined (see written Statement of objection on file with Clerk.

Homer Johnstone &
S H Wyse
Solicitors for Defendant T. E. Klipstein

Dec. 16, 1937

Receipt of a copy of the foregoing Findings of Fact and Conclusions of Law is hereby admitted this 16th day of December, 1937.

Homer Johnstone
S. H. Wyse
Solicitors for Defendant T. E. Klipstein

[Endorsed]: Filed Dec. 29, 1937. R. S. Zimmerman, Clerk By Louis J. Somers, Deputy Clerk.

IN THE DISTRICT COURT OF THE UNITED STATES, IN AND FOR THE SOUTHERN DISTRICT OF CALIFORNIA, NORTHERN DIVISION

—oOo—

HERBERT P. SEARS, Trustee of the Estate of Globe Drug Company, Inc., Bankrupt,	)	No. E-4
Complainant,	)	In Equity
vs.	)	DECREE
LEW O. STELZNER and T. E. KLIPSTEIN,	)	
Defendants.	)	

—oOo—

The Court having heretofore duly made its Findings of Fact and Conclusions of Law herein:

NOW, THEREFORE, pursuant to such Findings of Fact and Conclusions of Law, it is hereby ordered, adjudged and decreed as follows, to wit:

That the plaintiff, Herbert P. Sears, as trustee in bankruptcy of Globe Drug Company, Inc., a corporation, do have and recover of and from the defendants, Lew O. Stelzner and T. E. Klipstein, and each of them, such sum of money which, together with the present assets of the estate of said bankrupt, will suffice to satisfy all just and proper claims and reasonable allowances and expenses in such bankruptcy proceedings, which proceedings are pending in this court and numbered #4171 upon the records of said court, and have heretofore been referred to C. E. Arnold, Esq., Referee in Bankruptcy; that the

plaintiff herein, Herbert P. Sears, as trustee of said bankrupt estate, do presently have and recover of and from the defendants, Lew O. Stelzner and T. E. Klipstein, and each of them, the sum of $4,500.00.

That as soon as may be after the payment by defendants of said sum of $4,500.00, together with plaintiff's costs herein, a report shall be filed in this action by said C. E. Arnold, Referee in Bankruptcy, showing the exact amount necessary to satisfy all just and proper claims and reasonable allowances and expenses in the said bankruptcy proceedings, and plaintiff shall thereupon have and recover of and from said defendants, and each of them, the amount, if any, shown by such report to be necessary to satisfy all just and proper claims and reasonable allowances and expenses in said bankruptcy proceedings, and plaintiff shall be entitled to have execution therefor; that if such report shows that there is a balance remaining out of said sum of $4,500.00, after paying all just and proper claims and reasonable allowances and expenses in said bankruptcy proceedings, the excess thereof, if any, is to be paid to said defendants; but in no event shall plaintiff recover of defendants any amount in excess of said sum of $4500.00 together with interest at 6 per cent from date of entry of this decree, and costs herein assessed. [L.R.Y., Judge.]

That plaintiff shall have and recover from defendants, and each of them, his costs herein. Cost taxed at $73.68.

To all of which defendants, and each of them, except, and exception allowed.

Dated: December 29, 1937.

Leon R. Yankwich
United States District Judge

Not approved as to form by defendant Klipstein for the reason that same do not correctly state matters previously determined (see statement of objections on file with Clerk.

Dec. 16th, 1937

Homer Johnstone and
S. H. Wyse
Solicitors for defendant, T. E. Klipstein.

Receipt of a copy of the foregoing Decree is hereby admitted this 16th day of December, 1937.

Homer Johnstone
S. H. Wyse
Solicitors for defendant, T. E. Klipstein.

Decree entered and recorded Dec. 29, 1937

R. S. ZIMMERMAN,
Clerk
By Louis J. Somers,
Deputy Clerk

[Endorsed]: Filed Dec. 29, 1937. R. S. Zimmerman, Clerk By Louis J. Somers, Deputy Clerk.

[Title of District Court and Cause.]

ORDER TO SHOW CAUSE

TO THE PLAINTIFF, HERBERT P. SEARS, AND TO ARTHUR L. SHANNON AND CLARENCE A. SHUEY, HIS ATTORNEYS:

Upon reading the verified petition of T. E. Klipstein, one of the defendants in the above entitled cause, and the affidavits of Mel G. Brittan, T. E. Klipstein and Homer Johnstone, copies of which documents are attached hereto, and upon the motion of said Homer Johnstone, attorney for said defendant,

IT IS ORDERED that the plaintiff in said action show cause, if any he have, on the 31st day of March, 1938, at Court Room, Post Office Building, in the City of Fresno, County of Fresno, State of California, why a rehearing should not be granted in said action, or in the alternative, why the findings of fact, conclusions of law, and decree, heretofore entered, should not be modified, in accordance with the prayer of said petition.

Service of this order and the documents described herein shall be made upon the attorneys for plaintiff, either personally or at their office, on or before the 28th day of March, 1938.

Meanwhile, and until further order of this Court, let all proceedings under said decree in said cause be stayed.

Dated this 25th day of March, 1938.

Leon R. Yankwich
Judge

[Endorsed]: Filed Mar. 25, 1938. R. S. Zimmerman, Clerk By L. B. Figg, Deputy Clerk.

At a stated term, to wit: The October Term, A. D. 1937, of the District Court of the United States of America, within and for the Northern Division of the Southern District of California, held at the Court Room thereof, in the City of Fresno, on Saturday, the 2nd day of April, in the year of our Lord one thousand nine hundred and thirty-eight.

Present:

The Honorable LEON R. YANKWICH, District Judge.

Herbert P. Sears, Trustee, etc.,)
)
Plaintiff,)
)
vs.) No. E-4-Eq.
)
Lew O. Stelzner, et al.,)
)
Defendants.)

This cause coming on for hearing on order to show cause, filed March 25, 1938, on petition of T. E. Klipstein for rehearing, or in the alternative, for modification of Findings of Fact, Conclusions of Law and Decree; Arthur L. Shannon, Esq., appearing for the plaintiff; Homer Johnstone, Esq., appearing for petitioner T. E. Klipstein; David E. Peckinpah, Esq., appearing for defendant Lew O. Stelzner, who is also present in court;

Defendant Stelzner joins in the petition for rehearing etc., there being no objections thereto; and Attorney Johnstone argues in support of said petition; Attorney Shannon makes reply thereto; and Attorney Johnstone makes a statement in closing, and thereupon,

It is ordered that the Decree herein be modified as follows: by inserting in line 23, after the word "defendants"—"but in no event shall plaintiff recover of defendants any amount in excess of said sum of $4500.00, together with interest at 6 per cent from date of entry of this decree, and costs herein assessed" and the decree heretofore entered is modified accordingly, the Court making the change upon the face of the decree.

It is further ordered that the Petition for Rehearing herein be hereby denied and exception allowed to Petitioners. A stay of execution for twenty days is allowed.

It is further ordered that the term of court herein be hereby extended for a period of thirty days from this date within which to prepare Bill of Exceptions herein and for filing same.

[Title of District Court and Cause.]

STATEMENT OF EVIDENCE

Defendant and appellant T. E. Klipstein herewith presents the following statement of the evidence produced upon the trial of the above-entitled action deemed by said defendant and appellant necessary for the consideration of the errors assigned:

The cause came on for hearing on the 27th day of October, 1937, before the above-entitled Court, at Fresno, California, the Honorable Leon R. Yankwich, Judge presiding, plaintiff appearing by Arthur L. Shannon and Clarence A. Shuey, defendant Lew O. Stelzner by David E. Peckinpah and L. N. Barber, and defendant T. E. Klipstein by Homer Johnstone and Sidney H. Wyse, whereupon the following proceedings were had and the following evidence produced:

A preliminary motion to dismiss said action was made on behalf of defendant T. E. Klipstein upon the ground that the Court had no jurisdiction over said cause, as follows:

"MR. JOHNSTONE: I understand . . . that there is a motion to be made as to the jurisdiction of this court to handle this particular matter, and on behalf of the defendant Klipstein we desire to say that we object to the jurisdiction of this court and that we shall join with the defendant Stelzner in the same motion.

May it be stipulated, Mr. Shannon, that we may join in that motion without it being in a written form?

(Testimony of C. H. Landes)

MR. SHANNON: What motion is that?

MR. JOHNSTONE: A motion to dismiss by reason of lack of jurisdiction.

MR. SHANNON: That motion has been disposed of already.

MR. JOHNSTONE: We propose to renew it at this time. We haven't made any such motion, but by the stipulation to which I referred, we were given the right to present the motion at this time.

MR. SHANNON: All right.

THE COURT: I am going to overrule the motion, . . ."

C. H. LANDES,

called as a witness for plaintiff, testified as follows: I have been an officer of the Bank of America at Bakersfield, California, for the past 13 years; I am not familiar with any transaction between said bank and the defendants except in so far as the bank records show; said records indicate that on January 3, 1928, a loan of $17,000.00 was made by said Bank to Lew O. Stelzner, which loan was evidenced by a note in said sum payable April 3, 1928, with interest at the rate of 7 per cent per annum, and that the note was endorsed or secured by the signature of T. E. Klipstein; said records show that payments were made on the principal amount of said loan, upon the dates and in the amounts as follows, to wit:

DATE	AMOUNT
March 29, 1929	$ 500.00
June 24, 1929	500.00
Sept. 26, 1929	500.00

(Testimony of C. H. Landes)

DATE	AMOUNT
Dec. 24, 1929	$1,000.00
March 25, 1930	500.00
June 23, 1930	500.00
Sept. 22, 1930	500.00
Dec. 23, 1930	500.00
Mar. 23, 1931	500.00
June 19, 1931	500.00
Sept. 21, 1931	500.00
Dec. 28, 1931	500.00
March 19, 1932	500.00
June 16, 1932	500.00
Dec. 13, 1932	500.00
Aug. 1, 1933	250.00
Sept. 15, 1933	250.00
Jan. 29, 1934	500.00
Feb. 20, 1934	200.00
Mar. 20, 1934	200.00
Apr. 28, 1934	200.00
May 26, 1934	200.00
June 25, 1934	200.00
July 23, 1934	200.00
Aug. 24, 1934	200.00
Sept. 22, 1934	200.00
Oct. 23, 1934	200.00
Nov. 28, 1934	200.00
Dec. 24, 1934	200.00
Jan. 31, 1935	200.00
Feb. 28, 1935	200.00
Mar. 27, 1935	200.00
June 10, 1935	100.00
Aug. 9, 1935	100.00

(Testimony of C. H. Landes)

The record of a separate interest account shows payments of interest on said loan, upon the dates and in the amounts as follows, to wit:

DATE	AMOUNT
April 3, 1928	$ 300.81
July 6, 1928	304.11
Oct. 1, 1928	297.50
Nov. 24, 1928	12.60
March 29, 1929	294.24
June 24, 1929	291.19
Sept. 26, 1929	280.00
Dec. 24, 1929	271.25
Mar. 25, 1930	253.75
June 23, 1930	245.00
Sept. 22, 1930	238.82
Mar. 23, 1931	208.75
Sept. 21, 1931	201.25
Dec. 28, 1931	192.50
Mar. 9, 1932	184.15
June 16, 1932	175.00
Sept. 14, 1932	166.25
Dec. 13, 1932	166.25
July 10, 1933	32.42
Aug. 1, 1933	47.25
Sept. 15, 1933	15.74

(Testimony of C. H. Landes)

DATE	AMOUNT
Oct. 19, 1933	$ 47.93
Jan. 29, 1934	170.23
Feb. 20, 1934	34.22
Mar. 20, 1934	42.47
Apr. 28, 1934	44.43
Mar. 26, 1934	43.16
June 25, 1934	43.40
July 23, 1934	40.83
Aug. 24, 1934	40.99
Sept. 22, 1934	39.79
Oct. 23, 1934	34.85
Nov. 24, 1934	37.38
Dec. 24, 1934	35.00
Jan. 31, 1935	32.70
Feb. 28, 1935	33.66
Mar. 27, 1935	29.40
Apr. 30, 1935	31.35
June 10, 1935	29.17
Aug. 9, 1935	74.32;

from the notations contained thereon certain checks can be identified as having been applied on said principal and interest accounts.

The checks so identified by Mr. Landes were offered into evidence in a group as Plaintiff's Exhibit 1, over the objection of defendant T. E. Klipstein, as follows:

"MR. SHANNON: I am going to introduce all of these checks as Plaintiff's Exhibit 1, as one exhibit.

MR. JOHNSTONE: We object, may it please the court, to the introduction in evidence of these checks on the ground that they are incompetent, irrelevant and immaterial and if offered for any purpose it is to show pay-

(Testimony of C. H. Landes)

ments of more than three years prior to the filing of the within action, and therefore the Statute has run against the cause of action; and upon the further ground that there is no identification of the defendant Klipstein with the Globe Drug Company.

THE COURT: All right. The objection will be overruled.

THE CLERK: 1, in evidence.

MR. JOHNSTONE: Exception."

Said Plaintiff's Exhibit 1 consists of 15 checks, each drawn on Bank of America National Trust & Savings Association in favor of Bank of America National Trust & Savings Assocation by Globe Drug Company, Inc., by Lew O. Stelzner, said checks having been drawn on the following dates and for the following amounts respectively:

DATE OF ISSUE	AMOUNT
Jun. 16, 1932	$675.00
Sep. 13, 1932	166.25
Dec. 13, 1932	666.25
Mar. 15, 1933	157.50
Jun. 10, 1933	157.50
Jul. 10, 1933	42.00
Aug. 1, 1933	297.25
Sep. 15, 1933	302.74
Oct. 3, 1933	29.75
Oct. 19, 1933	47.93
Jan. 29, 1934	170.23
Feb. 20, 1934	234.22
Jan. 31, 1935	232.70
Feb. 28, 1935	233.66
Mar. 27, 1935	229.40

(Testimony of C. H. Landes)

Mr. Landes further testified: On October 19, 1935, the balance in said loan account was $4,800.00; on said day said balance was paid in full by the note of the Globe Drug Company, endorsed or secured by the signature of T. E. Klipstein, in the sum of $4,800.00.

The witness further testified that he could not locate any records that would indicate that Globe Drug Company, up to October 19, 1935, had any loan or outstanding loans with the bank.

Mr. Landes then identified photostatic copies of certain original records pertaining to the said loan transaction and said copies were offered into evidence as Plaintiff's Exhibit 3. Said exhibit shows what purports to be a loan account in the name of Lew O. Stelzner on the books of Bank of America National Trust & Savings Association; that on the 3rd day of January, 1928, a loan in the sum of $17,000.00, was made; that said amount was reduced from time to time until the 19th day of October, 1935, when the balance remaining was $4,800.00; that said balance was paid on that date. Said account carries in the margin the notation that said account is "endorsed or secured" by T. E. Klipstein.

It was thereupon stipulated by and between counsel for plaintiff and counsel for defendant and appellant T. E. Klipstein that the note of the Globe Drug Company was paid in full by said defendant and appellant T. E. Klipstein.

RICHARD A. PAWSON,

called as a witness for plaintiff, testified: I am the assistant credit manager and in charge of the customers' accounts receivable ledger of McKesson & Langley; I am familiar with the account of the Globe Drug Company; I have made a comparison of the dates on which payments were made on the $17,000.00 loan transaction, as testified to by Mr. Landes, with the state of the account of the Globe Drug Company.

Thereupon the following question was asked of the witness and the following proceedings had:

"MR. SHANNON: Now, during the recess, have you made a comparison between all the dates of payment of the $17,000.00 obligation testified to by Mr. Landes, and a comparison of the dates of those payments with the condition of the account of the Globe Drug Company on those corresponding dates?

WITNESS: I did.

MR. SHANNON: And what did you find with respect to the account of the Globe Drug Company, how it stood, whether there was a debit balance or whether it was paid up?

MR. JOHNSTONE: Just a minute; to which we object on the ground it is incompetent, irrelevant and immaterial and hearsay as to defendant Klipstein, and for the further ground that before this evidence is admissible, may it please the court, they must show that

(Testimony of Richard A. Pawson)

Klipstein had knowledge of some insolvent condition if there was any insolvent condition. Under any circumstances he could not be charged with knowledge of preference.

THE COURT: Overruled.

MR. JOHNSTONE: Note an exception."

Plaintiff's Exhibit 4 was thereupon introduced into evidence over the objection of defendant T. E. Klipstein, as follows:

"MR. SHANNON: Now, Mr. Pawson, did you make a form of capitulation, or list of those claims and the condition of the account of the Globe Drug Company?

MR. PAWSON: Yes, I did.

MR. SHANNON: Did you reduce it to writing on a piece of paper?

MR. PAWSON: Yes.

MR. SHANNON: Have you it with you?

MR. PAWSON: Yes.

MR. SHANNON: Now, you refer to that list having before you the dates of the payments on the $17,000.-00 account, and the amount of those payments, is that correct?

MR. PAWSON: Yes.

MR. SHANNON: And those figures that you have set forth on that statement, showing the condition of the

accounts, the debit balances of the Globe Drug Company on those particular dates, is that right?

MR. PAWSON: Yes.

MR. SHANNON: We offer it in evidence.

MR. JOHNSTONE: To which we object on the ground it is incompetent, irrelevant and immaterial and is not binding on the defendant Klipstein. There has been nothing to bring him within the action at the present time. He is not a stockholder, not a director, and if it is offered for the purpose of showing any apparent insolvent condition of the corporation, this is not the way to do it. They should show, for instance—I call your Honor's attention to the situation as it now stands, and that we believe will be shown here, that there never was any capital stock liability of the corporation; there never was any insolvent condition from a technical or actual standpoint, in all this period of time they have been bringing in evidence before here.

THE COURT: Overruled.

MR. JOHNSTONE: Exception."

Said Plaintiff's Exhibit 4 consists of several pages of note paper containing the following words and figures, in pencil:

(Testimony of Richard A. Pawson)

"Interest payments

Globe Drug Company
1601 — 19th St.

Bakersfield, California

DATE	BALANCE OUTSTANDING McKESSON
4/ 3/28	$ 884.22
7/ 6/28	790.76
10/ 1/28	629.34
11/24/28	1,154.71
3/29/29	693.74
6/24/29	1,163.16
9/22/29	1,332.75
12/24/29	1,850.96
3/25/30	923.46
6/23/30	1,607.22
9/22/30	1,422.44
3/23/31	1,492.74
9/21/31	1,565.34
9/28/31	1,103.76
3/19/32	1,264.92
6/16/32	986.32
9/14/32	899.86
12/13/32	1,697.23

(Testimony of Richard A. Pawson)

7/10/33	1,433.25
8/ 1/33	1,717.11
12/15/33	1,535.18
10/19/33	1,795.49
1/29/34	1,496.45
2/20/34	1,630.81
3/20/34	1,520.27
4/28/34	1,373.28
3/26/34	1,453.26
6/25/34	1,137.31
7/23/34	996.53
8/24/34	845.23
9/22/34	808.99
10/23/34	1,468.61
11/24/34	1,649.92
12/24/34	2,068.52
1/31/35	1,472.29
2/28/35	1,746.98
3/27/35	1,943.21
4/30/35	2,135.50
6/10/35	1,620.45
8/ 7/35	1,307.56
10/30/35	1,314.02
12/ 2/35	1,314.02"

(Testimony of Richard A. Pawson)

"Payments

Principal

DATE	BALANCE DUE McKESSON
3/29/29	$ 693.74
6/24/29	1,163.16
9/26/29	1,102.83
12/24/29	1,850.96
3/25/30	923.46
6/23/30	1,607.22
9/22/30	1,422.44
12/23/30	1,986.22
3/23/31	1,492.74
6/19/31	1,255.78
9/21/31	1,565.34
12/28/31	568.95
3/19/32	1,264.92
6/16/32	986.32
12/13/32	1,697.23
8/ 1/33	1,717.11
9/15/33	1,655.51
1/29/34	1,496.45
2/20/34	1,630.81
3/20/34	1,520.27
4/28/34	1,373.28
5/26/34	1,237.37
6/25/34	1,137.31
7/23/34	996.53
8/24/34	845.23

(Testimony of Richard A. Pawson)

9/22/34	808.99
10/23/34	1,468.61
11/28/34	1,767.04
12/24/34	2,068.52
1/31/35	1,472.29
2/28/35	1,746.98
3/27/35	1,943.21
6/10/35	1,620.45
8/ 9/35	1,307.56
10/19/35	1,314.02"

Thereupon the following questions were asked of the witness and the following proceedings had:

"MR SHANNON: Did you, or your firm, file a claim in the bankruptcy proceedings of the Globe Drug Company, Inc.?

MR. PAWSON: Yes. We filed our claim in the San Francisco Board of Trade.

MR. SHANNON: Do you remember the amount of that claim?

MR. PAWSON: $1,314.02.

* * * * * *

MR. BARBER: Do you know whether, as a matter of fact, you filed your claim with the Board of Trade before the bankruptcy proceedings were commenced or after?

MR. PAWSON: I can't answer that question."

LEW O. STELZNER,

one of the defendants, called as a witness for plaintiff, testified: I was an officer and director of the Globe Drug Company.

Thereupon Plaintiff's Exihibt 5 was offered into evidence over the objection of defendant T. E. Klipstein, as follows:

"MR. SHANNON: Now, Mr. Stelzner, do you recognize that book?

MR. STELZNER: (Examining document) Yes, I do.

MR. SHANNON: Is that the minute book of the Globe Drug Company, Inc.?

MR. STELZNER: It is.

MR. SHANNON: We are going to offer this in evidence, your Honor, the whole book for what it is worth to either side in this case, as Plaintiff's Exhibit next number in order.

MR. JOHNSTONE: We object to its introduction on the ground it is incompetent, irrelevant and immaterial and upon the grounds stated before, that the corporation has never been organized and the document itself it not the official record of the corporation that has completed its organization, and upon the ground that as to the defendant Klipstein it is entirely hearsay.

THE COURT: The objection is overruled.

MR. JOHNSTONE: Exception."

Said Plaintiff's Exihibt 5 shows that Globe Drug Company, Inc., was incorporated in the State of California on the 17th day of July, 1920, by Lew O. Stelzner, V. J.

(Testimony of Lew O. Stelzner)

Moore and James F. Brazill, with an authorized capital stock of $25,000.00 divided into 25,000 shares of the par value of $1.00 each, and with a Board of Directors consisting of three members. Written entries in said minute book purport to record the following transactions:

On December 31, 1927, at a stockholders' meeting of Globe Drug Company, Inc., Vergne J. Moore, Lew O. Stelzner, and G. D. Holmquist, holding 24,980 shares, were present and voting, T. E. Klipstein, Lew O. Stelzner, and Dorothy I. Stelzner were nominated and elected directors of the corporation for the ensuing year.

On December 31, 1927, at a Directors Meeting of Globe Drug Company, Inc., Lew O. Stelzner, T. E. Klipstein and Dorothy I. Stelzner being present and acting, T. E. Klipstein was nominated and elected Vice-President of the corporation.

On January 4, 1928, at a Directors Meeting of Globe Drug Company, Inc., Lew O. Stelzner, T. E. Klipstein and Dorothy I. Stelzner being present and acting, T. E. Klipstein was nominated and elected Secretary of the corporation; the minutes of said meeting were attested by the signature of T. E. Klipstein, Secretary.

From and after January 23, 1928, there is no record of any meetings of directors or stockholders of Globe Drug Company, Inc., until October 19, 1935, on which date was held a directors meeting, Lew O. Stelzner, T. E. Klipstein and Dorothy I. Stelzner being present, at which meeting a resolution was passed authorizing the corporation to borrow from the Bank of America National Trust & Savings Association the sum of $5,000.00; T. E. Klipstein signed his consent to the holding of said meeting as

a director, and was present and acting. The minutes of said meeting were attested by the signature of T. E. Klipstein, Secretary.

No further proceedings appear in said Minute Book.

Thereupon Plaintiff's Exhibit 6 was offered into evidence over the objection of defendant T. E. Klipstein, as follows:

"MR. SHANNON: Mr. Stelzner, isn't this what purports to be a stock certificate book? Look at it and see if you can recognize that.

MR. STELZNER: (Examining document.) Yes.

MR. SHANNON: Is that the stock certificate book of the Globe Drug Company?

MR. JOHNSTONE: To which we object on the grounds already stated, that, if it is a part of the plaintiff's case here, if we are going to, for any purpose at all, show that, they must show, as a part of their case, that Klipstein was a stockholder, and then the way to do it is to show that he had legal stock issued to him. They cannot by documents of this kind, made without authority of law, tie him in as a stockholder.

MR. SHANNON: We offer in evidence the stock book as the next in order.

MR. SHANNON: The stock book is admitted?

THE COURT: Yes.

MR. JOHNSTONE: An exception."

Certain stubs in said Plaintiff's Exhibit 6, from which certificates of stock have been detached, contain notations purporting to show that said detached certificates

(Testimony of Lew O. Stelzner)

had been issued on the following dates, for the following number of shares, and to the following persons respectively:

CERTIF. NO.	DATED	NO. SHARES	ISSUED TO
12	Jun 30, 1927	3000	Lew O. Stelzner
13	Dec 21, 1927	10	T. E. Klipstein
17	Jan 5, 1928	9990	T. E. Klipstein
19	Jun 14, 1932	5	Lew O. Stelzner
20	Jun 14, 1932	5	Dorothy I. Stelzner
21	Jun 14, 1932	3996-2/3	Thomas Lew Stelzner
22	Jun 14, 1932	3996-2/3	Gretchen Stelzner
23	Jun 14, 1932	3996-2/3	Mary Jean Stelzner

Said stub No. 17 bears the following notation: 'Received Certificate No. 17 for 9,990 shares this 16th day of January, 1928,' such notation being signed by T. E. Klipstein.

Mr. Stelzner further testified: I am the beneficial owner of the shares evidenced by certificates Nos. 21, 22 and 23, in the names of Thomas Lew Stelzner, Gretchen Stelzner and Mary Jean Stelzner, respectively; they are my children; T. E. Klipstein is my brother-in-law; the note for $17,000.00 given the Bank of America was signed by me and by Mr. Klipstein as joint makers; I received the proceeds of said loan and used the same to buy the stock held by the two other stockholders of the Globe Drug Company; all of the payments testified to by Mr. Landes as having been made upon said loan had been made from "store funds", corporate funds; said Company issued its note in the sum of $4,800.00 in pay-

ment of the balance of said loan on October 19, 1935; nothing was received by said Company in consideration for payments on the $17,000.00 note or for the execution of the $4,800.00 note; the corporation used the corporate funds to pay for the stock that I bought; I was served with a summons and complaint in the action of T. E. Klipstein v. Globe Drug Company, Inc., in the Superior Court for Kern County; I had not talked with T. E. Klipstein prior to said service and I knew nothing concerning said suit prior to said service; I took said copy of the summons and complaint in said action to my attorneys; I do not know what my attorneys did with said documents and to my knowledge no defense was put in on behalf of the Globe Drug Company; I had no real defense to said action and I knew that the money was owed to Mr. Klipstein and that I "just had to get out".

A certified copy of the judgment roll in said action was introduced into evidence as Plaintiff's Exhibit 7. Said exhibit shows that on the 19th day of October, 1935, an action was brought in the Superior Court of the State of California in and for the County of Kern, by T. E. Klipstein against Globe Drug Company, Inc., for the recovery of the sum of $5,364.00 alleged to be due from the defendant to plaintiff for moneys advanced to defendant, that the complaint in said action was verified by T. E. Klipstein, that said Globe Drug Company, Inc., was the only party defendant in said action, that service of the summons and complaint in said action was made on the 19th day of October, 1935, at Bakersfield, upon Lew O. Stelzner, individually and as President of Globe Drug Company, Inc., that the default of defendant was entered on the 5th day of November, 1935, and that judg-

(Testimony of Lew O. Stelzner)

ment against defendant and in favor of plaintiff in the sum of $5,383.82 and $177.00 costs was entered on the 8th day of November, 1935.

Mr. Stelzner further testified: The note for $17,-000.00 was signed by Mr. Klipstein as a personal accommodation to me and Mr. Klipstein never received any part of said moneys or anything else for said accommodation and had no interest in the drug business; no permit had ever been issued by the Corporation Commissioner of the State of California authorizing said Company to issue its shares.

A schedule in bankruptcy of the Globe Drug Company, Inc., was identified by Mr. Stelzner as that filed by him on behalf of said Company and was offered into evidence as Plaintiff's Exhibit 8.

Said Plaintiff's Exhibit 8 contains the following summary of the debts and assets of the bankrupt:

Summary of Debts and Assets

Taxes and Debts due U. S.	None
Taxes due States, Counties, Districts and Municipalities	$ 163.35
Wages	600.00
Unsecured claims	10,280.52
Total debts	$11,043.87
Cash on hand	$ 1,881.48
Debts due on Open Accounts	2,104.15
Total assets	$ 3,985.63

Said Plaintiff's Exhibit 8 further shows that included in the Unsecured Claims against said bankrupt is an item in the sum of $5,708.90, concerning which there appears the following notation:

(Testimony of Lew O. Stelzner)

"T. E. Klipstein, Brower Bldg., Bakersfield, California. This debt is represented by a judgment obtained on November 7, 1935 by the creditor against the corporation in an action filed in the Superior Court of the State of California, in and for the County of Kern, entitled "T. E. Klipstein, plaintiff, vs. Globe Drug Company, Inc., a corporation, Defendant," being Action Number 29015, for moneys advanced by said creditor to the corporation from time to time during the last four years; that an execution was issued upon this judgment and the fixtures and merchandise of the debtor were sold upon the same; that at said sale the sum of $1,935.00 was realized; that said money received from the sale, less the fees and expenses of said sale in the sum of $608.75 is being held by said judgment creditor for the benefit of all of the creditors in proportion to their claims"

Said Plaintiff's Exhibit 8 further shows an item of $1,316.31 included in the list of personal property, concerning which item there appears the following notation: 'Held by Brittan and Mack, attorneys for the benefit of creditors.'

Said Plaintiff's Exhibit 8 further shows an item of $565.17 included in the list of personal property, concerning which item there appears the following notation:

"Held by D. D. Cornwell, deputy Constable, to be returned for the benefit of the creditors. This amount was taken upon execution in an action entitled "T. E. Klipstein, plaintiff, vs. Globe Drug Company, Inc., a corporation, defendant", being an action brought in the Superior Court of the State of California, in and for the County of Kern, being action No. 29015, and the

(Testimony of Lew O. Stelzner)

judgment creditor in said action, Mr. T. E. Klipstein, of Bakersfield, California, has agreed with all of the creditors that this amount may be ratably distributed among the creditors in proportion to their claims."

Among the list of unsecured claims set forth in said schedule is one of McKesson, Langley and Michaels Co. for $1,314.02.

Plaintiff thereupon rested.

A motion to dismiss plaintiff's complaint was then made on behalf of T. E. Klipstein, as follows:

"MR. JOHNSTONE: May it please the court, on behalf of the defendant Klipstein, we move to dismiss as against that defendant on the grounds heretofore urged at the outset of the case: First, that this action is one that the cause of action is given to the trustee in bankruptcy, unquestionably by the Civil Code of this State, but he has mistaken the forum in which to try the action. The federal court, as such, has no jurisdiction over this type of action in the face of an objection by the defendant. I will not urge that argument further. I think the case is on all fours with the case decided by Justice Holmes.

On the further ground, may it please the court, as to the first cause of action, the defendant Klipstein cannot be held in this action for the reason that it shows if any moneys were paid to any person they were paid to the bank, and not to the defendant Klipstein. Klipstein cannot be held in this action on the theory that he received property that was taken, admittedly, for the sake of argument,

from the corporation's funds by the defendant Stelzner, and paid out on Stelzner's primary liability to the Bank.

We make the further objection, and ask the court to include it as one of the grounds of our motion to dismiss. that there has been absolutely no showing that Klipstein was a director, either de facto or otherwise, in view of the failure on the part of the plaintiff to show that there was ever a valid bona fide issue of stock. The minute book purports to show that Klipstein was elected at a meeting of the stockholders. There could have been no meeting of the stockholders unless there were valid shares issued under the laws as they stood at that time.

We make the further objection and ask to dismiss upon the ground that the cause of action, if it be under Section 363, or Section 366, is barred by the Statute of Limitations by the Civil Code of the State of California, Section 338, subdivisions 1 and 4."

THE COURT: The motions will be denied, gentlemen Exceptions to the parties."

MR. T. E. KLIPSTEIN,

defendant and appellant, was called as a witness for the defense and testified: In 1928 I aided Lew O. Stelzner in procuring the $17,000.00 from the Bank of America to buy out his partners; I was in the title business and had no interest in the drug company; the $17,000.00 was received by Mr. Stelzner; I never received any consideration of any kind for placing my name on said note; I never knew the Company had any unpaid creditors until several months immediately prior to filing the action of T. E. Klipstein v. Globe Drug Co.; I did not make any

(Testimony of Mr. T. E. Klipstein)

investigation to determine who the creditors were but subsequent to the filing of said action it was my understanding that all creditors were notified; the $17,000.00 loan had been paid down to $4,800.00 by Mr. Stelzner and at that time he was behind in his payments and I demanded that the corporation give me the $4,800.00 note to protect me; I at all times regarded Mr. Stelzner and Globe Drug Company as one and the same; my action against the Company was filed on advice of my attorney; at that time Mr. Stelzner wasn't able to pay his rent, was going into the hole from day to day, had a depleted stock of goods and no credit, and said action was brought for the good of Stelzner and everyone else; there is no question but that a saving was effected; the note of Globe Drug Company for $4,800.00 was never paid and was given back by me to the Company; that amount sued for, $5,364.00, in my action against the Company covered the $4,800.00 note and some $500.00 which I paid when Mr. Stelzner was behind in his payments to the bank in 1934; said action was brought to protect the Globe Drug Company from any further losses; all the creditors were sent a notice that they would share equally; I had no intention of taking any advantage by reason of the judgment; I instructed my attorney to file a claim in the bankruptcy proceedings of the Globe Drug Company and I further instructed my attorney to offer to waive said claim at the creditor's meeting; I was not at such meeting; the property of the Company was sold pursuant to an attachment issued in said action; prior to the sale the stock and fixtures were appraised by a druggist at $2,-200.00; 11 or 12 persons bid at the sale and that the sheriff accepted the highest bid from a Mr. Vest; the

(Testimony of Mr. T. E. Klipstein)

proceeds of said sale less costs and expenses were turned over to the trustee in bankruptcy and that nothing had ever been paid on the judgment.

Mr. Klipstein further testified on cross-examination; I do not remember whether Certificate No. 17 for 9,990 shares of Globe Drug Company stock was issued to me; I presume it was as shown by the stub but I do not have the certificate;

(At this point the minutes of the meetings of January 4, 1928 and October 19, 1935 were read to the witness.)

I am not familiar with the minutes of the Company but I signed the minutes of the directors meeting of January 4, 1928, and October 19, 1935, as shown in the minute book, Plaintiff's Exhibit 5; to the best of my knowledge I was made a director of the Company some ttime in January of 1928 I think; there were no meetings after that until the meeting held on October 19, 1935; the Company's note for $4,800.00 was executed pursuant to a resolution passed at said latter meeting; I signed the note as secretary of the Company; I presume the company weren't getting anything for the execution of that note; there wasn't any money exchanged; at the time I instructed my attorneys to bring suit against the Globe Drug Company I did not know that the same attorneys were also attorneys for the Company; I considered the judgment in said action a judgment against Lew O. Stelzner; I had a claim against Stelzner for $4,800.00 on the note and $500 advanced during 1934; I told my attorneys to protect me in any possible way and left it to them; said attorneys said nothing about not being able to represent me; my understanding from my

(Testimony of Mr. T. E. Klipstein)

attorneys was that all creditors were notified that suit was going to be brought; I have seen copies of letters written to some of the creditors; I don't know if they were sent out to all the creditors; savings to the creditors were effected by said suit; I was one of the creditors of Mr. Stelzner along with the others; I cannot get it out of my mind that Mr. Stelzner was the Globe Drug Company; I recognize a note given by me to the Bank of America, for $4,800.00; said note was given to the bank in connection with the balance of $4,800.00 on the $17,000.00 loan; said note was exchanged at the bank for the $4,800.00 of the Globe Drug Company; said note was paid by me with my own funds.

Said note was thereupon offered into evidence as defendant Klipstein's Exhibit A, being a promissory note in words and figures as follows:

"$4800.00 Bakersfield, Calif Oct 10, 1935

On January 9, 1936, for value received, I promise to pay in lawful money of the United States of America, to the order of the Bank of America National Trust & Savings Association at its office in this city Forty-eight hundred Dollars, with interest from date at the rate of 7 per cent per annum until paid. Payable on January 9, 1936 and . . . . thereafter, and in addition thereto in the event of commencement of suit to enforce payment of this note, such additional sums as attorneys' fees as the court may adjudge reasonable.

(Signed) T. E. KLIPSTEIN"

Mr. Klipstein further testified: It is my understanding that for a period of several months there was an attempt to bring about a composition of creditors to

prevent bankruptcy proceedings in regard to the Globe Drug Company; I think my attorney and Mr. Sears, the plaintiff in this action, represented all of the creditors.

It was stipulated by and between counsel for plaintiff and counsel for defendant and appellant T. E. Klipstein that the Corporation Commissioner of the State of California, if called as a witness for defendant would testify in accordance with the terms of a certain telegram offered into evidence as defendant Klipstein's Exhibit B, and being as follows:

"SACRAMENTO CALIF Oct. 21, 1937

HOMER JOHNSTONE
BARTLETT BLDG LOSA

GLOBE DRUG COMPANY FILED APPLICATION IN 1920 BUT NO PERMIT ISSUED

J. T. MC MENAMIN"

MR. HERBERT B. SEARS,

plaintiff in this action, was called as a witness for defendants and testified: I remember a meeting of creditors held in my office in an attempt to adjust the matters of the bankruptcy; I have in my possession a carbon copy of a letter written by me to the creditors; this letter was sent to the Board of Trade at San Francisco and the Los Angeles Wholesalers' Board of Trade; the letter is dated November 4, 1935; I don't believe I could tell you whether or not the creditors whose names were included in any schedule on file with me were given copies of this letter; Howard

(Testimony of Mr. Herbert B. Sears)

Cravath, T. E. Klipstein and I were the members of a committee of creditors; I generally represent the said Boards of Trade and I figured that said Boards of Trade would be in touch with all creditors; said Boards of Trade send out a regular notification sheet to all creditors; I have in my possession a copy of a letter dated November 14, 1935, which was sent to some of the creditors; I really can't say whether it was a regular circular letter or not; it might not contain anything of value; here is one paragraph:

"This office has been asked by Mr. Brittan, to handle the disbursement of the proceeds from the sale to the various creditors on a pro rata basis, which we have agreed to do. Therefore, if you will kindly file your claim for your account either with the Board of Trade of San Francisco or the Los Angeles Wholesalers' Board of Trade, or with this office, the same will be taken care of. If it is filed with either one of the Boards of Trade they will send the claim to this office as we represent them in this vicinity."; I was informed that it was the filing of the attachment suit that brought on the bankruptcy proceeding; the records of the Globe Drug Company, when they came into my hands, were very incomplete, very difficult to examine or ascertain anything from; we had quite a bit of trouble; the cancelled checks that were introduced this morning were all that I was able to find; I had looked for others, but couldn't find them.

All parties thereupon rested.

ORDER SETTLING STATEMENT OF EVIDENCE

It appearing to the Court that defendant and appellant T. E. Klipstein has filed herein his Statement of Evidence in said cause, together with the admission of service of counsel for plaintiff and appellee Herbert P. Sears of copies of said Statement of Evidence and of Notice of Lodgment thereof, and said plaintiff and appellee Herbert P. Sears having filed his Proposed Amendments to said Statement of Evidence, and said Statement of Evidence and said Proposed Amendments having been duly presented to the Court, pursuant to notice duly given, and the same having been duly considered by the Judge of this Court who presided at the trial of said cause, and said Statement of Evidence having been amended pursuant to the direction of said Judge, and the same, as amended, appearing to contain all of the material evidence in said cause and to be in all respects complete and proper;

IT IS ORDERED AND CERTIFIED that the above and foregoing instrument denominated Statement of Evidence and composed of pages 1 to 23 inclusive be and the same is hereby approved, settled and allowed as the Statement of Evidence in the above-entitled cause.

Done at Los Angeles, California, this 18th day of July, 1938.

Leon R. Yankwich
Judge.

[Endorsed]: Filed Jul. 18, 1938 R. S. Zimmerman, Clerk By Edmund L. Smith, Deputy Clerk.

[Title of District Court and Cause.]

STIPULATION FOR ORDER OF SEVERANCE

IT IS HEREBY STIPULATED by and between defendant T. E. Klipstein and defendant Lew O. Stelzner, through their respective attorneys, that defendant Lew O. Stelzner has been duly notified and requested by defendant T. E. Klipstein to join with said defendant in a petition for an appeal from the decree hitherto made and entered in the above entitled cause, that defendant Lew O. Stelzner has failed and refused to join in said appeal, and that an order may be made and entered by the above entitled Court granting leave to defendant T. E. Klipstein to prosecute his said appeal without joining defendant Lew O. Stelzner as a party appellant.

Dated this 10th day of May, 1938.

HOMER JOHNSTONE
SIDNEY H. WYSE
By Homer Johnstone
Attorneys for defendant T. E. Klipstein

DAVID E. PECKINPAH
L. N. BARBER
By L. N. Barber
Attorneys for defendant Lew O. Stelzner

[Endorsed]: Filed May 20, 1938 R. S. Zimmerman, Clerk By L. B. Figg, Deputy Clerk

[Title of District Court and Cause.]

ORDER OF SEVERANCE

Upon reading and filing the Stipulation heretofore entered into by and between defendant T. E. Klipstein and defendant Lew O. Stelzner, through their respective attorneys, and it appearing therefrom that said defendant T. E. Klipstein has duly notified and requested said defendant Lew O. Stelzner to join with said defendant T. E. Klipstein in an appeal from a decree of this Court made and entered in the above entitled cause and that said defendant Lew O. Stelzner has failed and refused so to join in such appeal,

IT IS HEREBY ORDERED that defendant T. E. Klipstein be allowed to prosecute said appeal alone, without joining defendant Lew O. Stelzner as a party appellant, and that the appeal of said defendant T. E. Klipstein is hereby severed for such purpose.

Dated this 20th day of May, 1938.

Leon R Yankwich
Judge of the United States District Court for the Southern District of California, Northern Division.

[Endorsed]: Filed May 20, 1938 R. S. Zimmerman, Clerk By L. B. Figg, Deputy Clerk.

IN THE DISTRICT COURT OF THE UNITED STATES, IN AND FOR THE SOUTHERN DISTRICT OF CALIFORNIA, NORTHERN DIVISION

—ooOoo—

HERBERT P. SEARS, Trustee of the Estate of Globe Drug Company, Inc., Bankrupt,	:	
	:	No. E-4
Complainant,	:	In Equity
	:	PETITION FOR
vs.	:	APPEAL AND
	:	ORDER
LEW O. STELZNER and	:	ALLOWING
T. E. KLIPSTEIN,	:	APPEAL
	:	
Defendants.	:	

. . . .

To the Honorable Leon R. Yankwich, Judge of the United States District Court for the Southern District of California:

Your petitioner, T. E. Klipstein, one of the defendants in the above entitled action, respectfully shows:

That he is aggrieved by the decree entered in said cause on the 29th day of December, 1937, as modified and amended by an order of this Court made and entered on the 2nd day of April, 1938; that the errors upon which your petitioner proposes to base his appeal are contained in an assignment of errors filed herewith.

Wherefore, your petitioner prays that he be allowed to appeal from said decree to the United States Circuit Court of Appeals for the Ninth Circuit; that a citation be issued in accordance with law; that an authenticated transcript of the record, proceedings and exhibits on the trial be forwarded to the said United States Circuit Court of Appeals for the Ninth Circuit, at San Francisco, California;

And your petitioner further prays that an order be made fixing the amount of security to be given by appellant as provided by law and that execution on said decree be superseded until final determination of said appeal.

Homer Johnstone

Sidney H. Wyse

Attorneys for Defendant and Appellant T. E. Klipstein

IT IS ORDERED that an appeal herein be allowed upon appellant furnishing a bond on appeal in the amount of Six Thousand ($6000.00) Dollars, the same to operate as a supersedeas as well as a bond for costs and damages.

By the Court:

Leon R. Yankwich

Judge

[Endorsed]: Filed Apr. 25, 1938. R. S. Zimmerman, Clerk By L. B. Figg, Deputy Clerk

[TITLE OF DISTRICT COURT AND CAUSE.]

ASSIGNMENT OF ERRORS

Comes now T. E. Klipstein, defendant and appellant herein, and files the following assignment of errors upon which he will rely upon appeal to the United States Circuit Court of Appeals for the Ninth Circuit:

I

The Court erred in denying defendant's motion to dismiss plaintiff's complaint herein, as follows:

"MR. JOHNSTONE: I understand . . . that there is a motion to be made as to the jurisdiction of this court to handle this particular matter, and on behalf of the defendant Klipstein we desire to say that we object to the jurisdiction of this court and that we shall join with the defendant Stelzner in the same motion.

May it be stipulated, Mr. Shannon, that we may join in that motion without it being in a written form?

MR. SHANNON: What motion is that?

MR. JOHNSTONE: A motion to dismiss by reason of lack of jurisdiction.

MR. SHANNON: That motion has been disposed of already.

MR. JOHNSTONE: We propose to renew it at this time. We haven't made any such motion, but by the stipulation to which I referred, we were given the right to present the motion at this time.

MR. SHANNON: All right.

THE COURT: I am going to overrule the motion, . . ."

II

The Court erred in overruling defendant's objection to the introduction into evidence of Plaintiff's Exhibit 1, as follows:

"MR. SHANNON: I am going to introduce all of these checks as Plaintiff's Exhibit 1, as one exhibit.

MR. JOHNSTONE: We object, may it please the Court, to the introduction in evidence of these checks on the ground that they are incompetent, irrelevant and immaterial and if offered for any purpose it is to show payments of more than three years prior to the filing of the within action, and therefore the Statute has run against the cause of action; and upon the further ground that there is no identification of the defendant Klipstein with the Globe Drug Company.

THE COURT: All right. The objection will be overruled.

THE CLERK: 1, in evidence.

MR. JOHNSTONE: Exception."

III

The Court erred in overruling defendant's objection to the question asked plaintiff's witness, Mr. Pawson, on direct examination, as follows:

"MR. SHANNON: Now, during the recess, have you made a comparison between all the dates of payment of the $17,000.00 obligation testified to by Mr. Landes, and a comparison of the dates of those payments with the condition of the account of the Globe Drug Company on those corresponding dates?

WITNESS: I did.

MR. SHANNON: And what did you find with respect to the account of the Globe Drug Company, how it stood, whether there was a debit balance or whether it was paid up?

MR. JOHNSTONE: Just a minute; to which we object on the ground it is incompetent, irrelevant and immaterial and hearsay as to defendant Klipstein, and for the further ground that before this evidence is admissible, may it please the court, they must show that Klipstein had knowledge of some insolvent condition if there was any insolvent condition. Under any circumstances he could not be charged with knowledge of preference.

THE COURT: Overruled.

MR. JOHNSTONE: Note an exception."

IV

The Court erred in overruling defendant's objection to the introduction into evidence of Plaintiff's Exhibit 4, as follows:

"MR. SHANNON: Now, Mr. Pawson, did you make a form of capitulation, or list of those claims and the condition of the account of the Globe Drug Company?

MR. PAWSON: Yes, I did.

MR. SHANNON: Did you reduce it to writing on a piece of paper?

MR. PAWSON: Yes.

MR. SHANNON: Have you it with you?

MR. PAWSON: Yes.

MR. SHANNON: Now, you refer to that list having before you the dates of the payments on the $17,000.00

account, and the amount of those payments, is that correct?

MR. PAWSON: Yes.

MR. SHANNON: And those figures that you have set forth on that statement, showing the condition of the accounts, the debit balances of the Globe Drug Company on those particular dates, is that right?

MR. PAWSON: Yes.

MR. SHANNON: We offer it in evidence.

MR. JOHNSTONE: To which we object on the ground it is incompetent, irrelevant and immaterial and is not binding on the defendant Klipstein. There has been nothing to bring him within the action at the present time. He is not a stockholder, not a director, and if it is offered for the purpose of showing any apparent insolvent condition of the corporation, this is not the way to do it. They should show, for instance—I call your Honor's attention to the situation as it now stands, and that we believe will be shown here, that there never was any capital stock liability of the corporation; there never was any insolvent condition from a technical or actual standpoint, in all this period of time they have been bringing in evidence before here.

THE COURT: Overruled.

MR. JOHNSTONE: Exception."

V

The Court erred in overruling defendant's objection to the introduction into evidence of Plaintiff's Exhibit 5, as follows:

"MR. SHANNON: Now, Mr. Stelzner, do you recognize that book?

MR. STELZNER: (Examining document.) Yes, I do.

MR. SHANNON: Is that the minute book of the Globe Drug Company Inc.?

MR. STELZNER: It is.

MR. SHANNON: We are going to offer this in evidence, your Honor, the whole book for what it is worth to either side in this case, as Plaintiff's Exhibit next number in order.

MR. JOHNSTONE: We object to its introduction on the ground it is incompetent, irrelevant and immaterial and upon the grounds stated before, that the corporation has never been organized and the document itself is not the official record of the corporation that has completed its organization, and upon the ground that as to the defendant Klipstein it is entirely hearsay.

THE COURT: The objection is overruled.

MR. JOHNSTONE: Exception."

VI

The Court erred in overruling defendant's objection to the introduction into evidence of Plaintiff's Exhibit 6, as follows:

"MR. SHANNON: Mr. Stelzner, isn't this what purports to be a stock certificate book? Look at it and see if you can recognize that.

MR. STELZNER: (Examining document.) Yes.

MR. SHANNON: Is that the stock certificate book of the Globe Drug Company?

MR. JOHNSTONE: To which we object on the grounds already stated, that, if it is a part of the plaintiff's case here, if we are going to, for any purpose at all,

show that, they must show, as a part of their case, that Klipstein was a stockholder, and then the way to do it is to show that he had legal stock issued to him. They cannot, by documents of this kind, made without authority of law, tie him in as a stockholder.

MR. SHANNON: We offer in evidence the stock book as the next in order.

MR. SHANNON: The stock book is admitted?

THE COURT: Yes.

MR. JOHNSTONE: An exception."

VII

The Court erred in denying defendant's motion to dismiss plaintiff's complaint at the close of plaintiff's evidence as follows:

"MR. JOHNSTONE: May it please the court, on behalf of the defendant Klipstein, we move to dismiss as against that defendant on the grounds heretofore urged at the outset of the case: First, that this action is one that the cause of action is given to the trustee in bankruptcy, unquestionably by the Civil Code of this State, but he has mistaken the forum in which to try the action. The federal court, as such, has no jurisdiction over this type of action in the face of an objection by the defendant. I will not urge that argument further. I think the case is on all fours with the case decided by Justice Holmes.

On the further ground, may it please the court, as to the first cause of action, the defendant Klipstein cannot be held in this action for the reason that it shows if any moneys were paid to any person that they were paid to the bank, and not to the defendant Klipstein. Klipstein cannot be held in this action on the theory that he received property that was taken, admittedly, for the sake of

argument, from the corporation's funds by the defendant Stelzner, and paid out on Stelzner's primary liability to the bank.

We make the further objection, and ask the court to include it as one of the grounds of our motion to dismiss, that there has been absolutely no showing that Klipstein was a director, either de facto or otherwise, in view of the failure on the part of the plaintiff to show that there was ever a valid bona fide issue of stock. The minute book purports to show that Klipstein was elected at a meeting of the stockholders. There could have been no meeting of the stockholders unless there were valid shares issued under the laws as they stood at that time.

We make the further objection and ask to dismiss upon the ground that the cause of action, if it be under Section 363, or Section 366, is barred by the Statute of Limitations by the Civil Code of the State of California, Section 338, subdivisions 1 and 4."

THE COURT: The motions will be denied, gentlemen. Exceptions to the parties."

VIII

The Court erred in denying defendant's motion, made at the conclusion of the case after all parties had rested, for judgment in favor of defendant by reason of an entire failure of proof. Said motion, among others, was presented in writing by the defendant in lieu of oral presentation, and was denied by the Court with exceptions to the defendants, as follows:

"THE COURT: What do you desire in regard to this matter, gentlemen?

MR. SHANNON: Well, if your Honor would like oral argument I will stay and argue, but I would be just as willing to go home and submit on briefs.

MR. JOHNSTONE: I think in view of the several questions involved that we would prefer to submit it on briefs.

THE COURT: The case will stand submitted on briefs."

(DEFENDANT'S BRIEF): "There was a complete failure of proof necessary to entitle complainant to a recovery against defendant Klipstein."

****

"Defendant Klipstein therefore asks this Court to declare by its judgment that neither in equity or law has the complainant the right to recover any part of the moneys by him claimed."

Whereupon, and after consideration thereof, the Court made the following order:

". . . the cause having been submitted to the Court for decision, and the Court having considered the evidence and the law and the arguments and briefs of counsel, now finds in favor of the plaintiff and (upon the authority of In re Wright Motor Company (C. C. A. 9, 1924) 299 Fed 106) orders a decree entered ordering and decreeing that plaintiff do have and recover from the defendants Lew O. Stelzner and T. E. Klipstein and each of them, the sum of $4,255.54 and accrued interest, the same being the sums shown to have been illegally withdrawn and paid out by the defendants and for which they are liable to account to the plaintiff."

Exception to the defendants."

IX

The Court erred in denying defendant's motion, made at the conclusion of the case after all parties had rested, for judgment in favor of defendant by reason of complainant's failure to prove that defendant Klipstein received any benefit whatever from any transaction in question. Said motion, among others, was denied by the Court with exceptions to the defendants.

X

The Court erred in denying defendant's motion, made at the conclusion of the case after all parties had rested, for judgment in favor of defendant by reason of complainant's failure to prove that said defendant Klipstein ever became or ever was a director of the Globe Drug Company. Said motion, among others, was denied by the Court with exceptions to the defendants.

XI

The Court erred in denying defendant's motion, made at the conclusion of the case after all parties had rested, for judgment in favor of the defendant upon the ground that complainant was estopped from asserting his alleged cause of action. Said motion, among others, was denied by the Court with exceptions to the defendants.

XII

The Court erred in making and entering its Finding of Fact Number II as follows:

"That at all times herein mentioned said Globe Drug Company, Inc. was a corporation duly organized and existing under and by virtue of the laws of the State of California; that ever since January 3, 1928, the defendant Lew O. Stelzner was a stockholder, the president and

one of the members of the Board of Directors of said corporation and the defendant T. E. Klipstein was a stockholder, the secretary, and one of the members of the Board of Directors of said corporation.";

to which said finding an exception in favor of defendant was duly allowed and noted at the foot of the Findings of Fact and Conclusions of Law.

For the reason that there is no competent evidence in the record to support such finding.

XIII

The Court erred in making and entering its Finding of Fact Number III, as follows:

"That on January 3, 1928, the defendants Lew O. Stelzner and T. E. Klipstein borrowed the sum of $17,-000.00 from the Bank of America, and in consideration of such loan executed to such bank their personal joint and several promissory note for the same; that said sum of $17,000.00 was thereupon used by said defendants for the purpose of purchasing certain issued and outstanding shares of said Globe Drug Company, Inc., for their own personal and individual accounts.";

to which said finding an exception in favor of defendants was duly allowed and noted at the foot of the Findings of Fact and Conclusions of Law.

For the reason that there is no competent evidence in the record to support such finding.

XIV

The Court erred in making and entering its Finding of Fact Number IV, as follows:

"That during the period of time from the execution of said note up to October 19, 1935, various payments were

made on account of the principal and interest of said note, aggregating a sum in excess of $12,200.00; that all of such payments were made by, and directly from and with the funds of, said corporation; that at each and all of the times when said payments were made as aforesaid, said corporation owed various sums of money to various creditors, such indebtedness at such times being in excess of the amounts of such respective payments; that no consideration whatsoever was ever received by said corporation for or in connection with any of said payments; that for a period of at least three years prior to the date of its adjudication in bankruptcy, said corporation was in an insolvent condition; that the payments made by said corporation on the personal note of said defendants during said three-year period aggregated a sum of at least $4,255.54; that each and all of said payments were made as aforesaid with the purpose and intent on the part of said corporation, and of said defendants, of hindering, delaying, and defrauding the creditors of said corporation.";

to which said finding an exception in favor of defendant was duly allowed and noted at the foot of the Findings of Fact and Conclusions of Law.

For the reason that there is no competent evidence in the record to support such finding.

XV

The Court erred in making and entering its Finding of Fact Number V, as follows:

"That on or about October 19, 1935, there remained unpaid on the principal of said promissory note a balance of $4,800.00; that on or about said date defendants, acting as directors and officers of said corporation, caused

to be executed to said Bank of America the promissory note of said corporation in the sum of $4,800.00; that said note was thereupon accepted by said bank in payment of the balance due on said promissory note of the defendants; that said corporation received no consideration for the execution of said note; either directly or indirectly."; to which said finding an exception in favor of defendant was duly allowed and noted at the foot of the Findings of Fact and Conclusions of Law.

For the reason that there is no competent evidence in the record to support such finding.

XVI

The Court erred in making and entering its Finding of Fact Number VI, as follows:

"That shortly after the execution of said last mentioned promissory note, the defendant Klipstein purchased the same from said bank and thereupon, and on October 19, 1935, commenced an action in the Superior Court of the State of California, in and for the County of Kern, to recover from said corporation the amount alleged by him to have been so paid in the purchase of said note;
illegally and without right or cause [LRY]
that thereafter the defendants, ~~fraudulently~~ permitted said corporation to suffer a default judgment to be entered in said action against it for the sum of $5,364.00; that thereafter execution was issued on said judgment, pursuant to which all of the properties and assets of said corporation were sold at public auction by the sheriff of said county.";

to which said finding an exception in favor of defendant was duly allowed and noted at the foot of the Findings of Fact and Conclusions of Law.

For the reason that there is no competent evidence in the record to support such finding.

XVII

The Court erred in making and entering its Finding of Fact Number VII, as follows:

"That at the time said action was commenced and said execution sale was effected as aforesaid, said corporation owed various sums of money to various creditors and was insolvent, and said action was commenced and prosecuted, such judgment was suffered to be taken, and said execution sale effected with the purpose and intent on the part of said corporation and the defendants of hindering, delaying, and defrauding the creditors of said corporation.";

to which said finding an exception in favor of defendant was duly allowed and noted at the foot of the Findings of Fact and Conclusions of Law.

For the reason that there is no competent evidence in the record to support such finding.

XVIII

The Court erred in making and entering its Finding of Fact Number VIII, as follows:

"That the payments made out of said corporation's funds as aforesaid, were authorized and consented to by the defendants while they were acting as officers and

directors of said corporation, and while they were stockholders thereof; that said payments were not made out of surplus or net profits of said corporation, nor was said corporation then in the process of winding up or dissolution; that said payments were made without the vote or written consent of any of the shares of said corporation other than the shares held by the defendants; that no permit of the Commissioner of Corporations of the State of California was ever applied for or issued authorizing such payments.";

to which said finding an exception in favor of defendant was duly allowed and noted at the foot of the Findings of Fact and Conclusions of Law.

For the reason that there is no competent evidence in the record to support such finding.

XIX

The Court erred in making and entering its Finding of Fact Number IX, as follows:

"That this action is not barred by any statute of limitations of the State of California, or otherwise; nor is plaintiff chargeable with any laches in the commencement and maintenance of this action; nor is plaintiff estopped from commencing and maintaining this action.";

to which said finding an exception in favor of defendant was duly allowed and noted at the foot of the Findings of Fact and Conclusions of Law.

For the reason that there is no competent evidence in the record to support such finding.

XX

The Court erred in making and entering its Finding of Fact Number X, as follows:

"That this Court has jurisdiction over this action.";
to which said finding an exception in favor of defendant was duly allowed and noted at the foot of the Findings of Fact and Conclusions of Law.

For the reason that said finding is erroneous in law.

XXI

The Court erred in making and entering its Conclusion of Law Number I, as follows:

"That all the payments made out of said corporation's funds as above described, were wrongfully and illegally
in law [LRY]
made, and were and are fraudulent ^ and void as to plaintiff."
to which said conclusion of law an exception in favor of defendant was duly allowed and noted at the foot of the Findings of Fact and Conclusions of Law.

For the reason that such conclusion of law is not supported by the evidence or by the facts found.

XXII

The Court erred in making and entering its Conclusion of Law Number II, as follows:

"That defendants shall pay to plaintiff, as trustee in bankruptcy of said corporation, such sum of money which, together with the present assets of the estate of said bankrupt, will suffice to satisfy all just and proper claims

and reasonable allowances and expenses in such bankruptcy proceedings, which amount is tentatively estimated at the sum of $4,500.00."

to which said conclusion of law an exception in favor of defendant was duly allowed and noted at the foot of the Findings of Fact and Conclusions of Law.

For the reason that such conclusion of law is not supported by the evidence or by the facts found;

And for the further reason that said conclusion of law is void for uncertainty in that it cannot be determined therefrom what are the "just and proper claims and reasonable allowances and expenses" by which the liability of defendant to plaintiff is to be determined.

XXIII

The Court erred in making and entering its Conclusion of Law Number III, as follows:

"That as soon as may be after the payment by defendants of said sum of $4,500.00 and plaintiff's costs herein, a report shall be filed in this proceeding by the Referee in Bankruptcy, showing the exact amount necessary to satisfy all just and proper claims and reasonable allowances and expenses in the said bankruptcy proceedings, and plaintiff shall thereupon have and recover of and from the defendants, and each of them, the amount, if any, shown by such report to be yet necessary to satisfy all just and proper claims and reasonable allowances and expenses in said bankruptcy proceedings, and plaintiff shall be entitled to have execution therefor; that if such re-

port shows that there is a balance remaining out of said sum of $4,500.00, after paying all just and proper claims and reasonable allowances and expenses in said bankruptcy proceedings, the excess thereof, if any, is to be paid to said defendants.

to which said conclusion of law an exception in favor of defendant was duly allowed and noted at the foot of the Findings of Fact and Conclusions of Law.

For the reason that such conclusion of law is not supported by the evidence or by the facts found;

For the further reason that said conclusion of law is void for uncertainty in that it cannot be determined therefrom what are the "just and proper claims and reasonable allowances and expenses" by which the liability of defendant to plaintiff is to be determined.

And for the further reason that said conclusion of law is void in that the liability of defendant to plaintiff is made by said conclusion to depend upon a report to be filed by the Referee in Bankruptcy in the matter of the estate of the Globe Drug Company, Inc., bankrupt, in which proceeding in bankruptcy defendant is not represented and has no standing and defendant is therefore by said conclusion deprived of his day in court to litigate the reasonableness and propriety of any allowances and expenses included in said report to be filed by said Referee.

XXIV

The Court erred in making and entering its decree, as amended, for the reason that there is no substantial evidence to sustain said decree.

XXV

The Court erred in making and entering its decree, as amended, for the reason that the facts found do not sustain said decree.

XXVI

The Court erred in making and entering its decree, as amended, for the reason that said decree is void for uncertainty in that the amount of defendant's liability to plaintiff cannot be determined therefrom.

XXVII

The Court erred in making and entering its decree, as amended, for the reason that said decree is void in that the liability of defendant to plaintiff is made by said decree to depend upon a report to be filed by one C. E. Arnold, Referee in Bankruptcy in the matter of the estate of the Globe Drug Company, Inc., bankrupt, in which proceeding in bankruptcy defendant is not represented and has no standing and defendant is therefore by said decree deprived of his day in court to litigate the reasonableness and propriety of any allowances and expenses included in said report to be filed by said Referee.

XXVIII

The Court erred in denying defendant's petition for a rehearing upon the ground of newly discovered evidence, said evidence being that no claim of defendant against Globe Drug Company, based either upon the judgment in the sum of $5,364.00, or otherwise, had ever been filed with plaintiff, as trustee in bankruptcy of the Globe Drug

Company, and that the time for such filing had expired, an exception to which ruling was taken by defendant and duly allowed by the Court.

PRAYER FOR REVERSAL

Comes now T. E. Klipstein, defendant and appellant herein, and prays for a reversal of the decree of the United States District Court for the Southern District of California, made and entered the 29th day of December, 1937, as amended by an order of said Court made and entered on the 2nd day of April, 1938.

Dated this 25th day of April, 1938.

HOMER JOHNSTONE
SIDNEY H. WYSE
By Homer Johnstone
Attorneys for appellant.

[Endorsed]: Filed Apr. 25, 1938. R. S. Zimmerman, Clerk By L. B. Figg, Deputy Clerk.

[Title of District Court and Cause.]

UNDERTAKING ON APPEAL FROM A MONEY JUDGMENT, AND FOR COSTS

KNOW ALL MEN BY THESE PRESENTS: That we, T. E. Klipstein as principal, and Hartford Accident and Indemnity Company, a corporation organized and existing under the laws of the State of Connecticut and duly licensed to transact a general surety business in the State of California, as surety, are held and firmly bound unto the above-named HERBERT P. SEARS, Trustee of The Estate of Globe Drug Company, Inc., Bankrupt, in the sum of Six Thousand Dollars ($6,000.00); to which payment well and truly to be made, we bind ourselves jointly and severally, our heirs, executors, successors and assigns, respectively, firmly by these presents.

Sealed with our seals and dated this 26th day of April, 1938.

WHEREAS, the above-named defendant, T. E. Klipstein, has prosecuted his appeal to the United States Circuit Court of Appeals for the Ninth Circuit to reverse the decree entered in said cause, by the United States District Court for the Southern District of California, Northern Division, on the 29th day of December, 1937, as modified and amended by an order of said Court made and entered on the 2nd day of April, 1938, against said defendant T. E. Klipstein for the sum of Four Thousand Five Hundred Dollars ($4,500.00), including interest and costs.

NOW, THEREFORE, the condition of this obligation is such that if the above-named defendant T. E. Klipstein, shall prosecute his appeal to effect and answer all costs and damages if he fails to make good his plea, then this obligation to be void, otherwise in full force and virtue.

IN WITNESS WHEREOF, said principal has affixed his signature hereto, and the said HARTFORD ACCIDENT AND INDEMNITY COMPANY, has caused these presents to be executed and its official seal attached hereto by its duly authorized ATTORNEY IN FACT, at Los Angeles, California this 26th day of April A. D., 1938.

T. E. Klipstein
Principal

[Seal] HARTFORD ACCIDENT AND INDEMNITY COMPANY,

By E. H. Clare
Its Attorney-in-Fact

APPROVED:

Leon R. Yankwich
Judge.

STATE OF CALIFORNIA)
) ss.
COUNTY OF LOS ANGELES)

On this 26th day of April, 1938, before me, a Notary Public in and for the State of California and the County of Los Angeles, personally appeared T. E. KLIPSTEIN, known to me to be the person whose name is subscribed to the within instrument, and acknowledged to me that he executed the same.

[Seal] Helen M. Kilgore
Notary Public in and for the County of Los Angeles, State of California

STATE OF CALIFORNIA)
) ss.
COUNTY OF LOS ANGELES)

On this 26th day of April, in the year 1938, before me, a Notary Public in and for the State and County aforesaid, personally appeared E. H. CLARE, known to me to be the attorney-in-fact of the corporation that executed the within instrument, and acknowledged to me that such corporation executed the same.

[Seal] Helen M. Kilgore
Notary Public in and for the County of Los Angeles, State of California

Examined & recommended for approval as provided in Rule 28.

Homer Johnstone & S. H. Wyse
Attorneys for Appellant

[Endorsed]: Filed Apr. 26, 1938. R. S. Zimmerman, Clerk By L. B. Figg, Deputy Clerk.

[Title of District Court and Cause.]

STIPULATION

IT IS HEREBY STIPULATED by and between Herbert P. Sears, plaintiff and appellee, and T. E. Klipstein, defendant and appellant, in the above-entitled cause, by and through their respective attorneys, that there may be omitted from the transcript of the record of said cause on appeal to the Circuit Court of Appeals for the Ninth Circuit all affidavits of personal service or service by mail and all acknowledgments of service of the various pleadings and documents to be incorporated in said transcript.

Dated this 24 day of May, 1938.

A. L. Shannon
C. A. Shuey
Attorneys for plaintiff and appellee

Herbert P. Sears.
Homer Johnstone
Sidney H. Wyse
Attorneys for defendant and appellant

T. E. Klipstein.

[Endorsed]: Filed Aug. 2, 1938. R. S. Zimmerman, Clerk By L. B. Figg, Deputy Clerk.

[TITLE OF DISTRICT COURT AND CAUSE.]

PRAECIPE

TO THE CLERK OF THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF CALIFORNIA:

You will please incorporate in the transcript of the record on appeal to the Circuit Court of Appeals for the Ninth Circuit, in the above entitled cause, the following, omitting therefrom all affidavits of personal service or service by mail, acknowledgments of service, and endorsements, except the dates of filing.

1. Answer of Defendant Lew O. Stelzner.

2. If Motion to Dismiss Bill of Complaint is inserted, order denying such motion should also be inserted.

Dated: July 25, 1938.

A. L. Shannon
C. A. Shuey
Attorneys for Plaintiff

[Endorsed]: Filed Jul. 26, 1938. R. S. Zimmerman, Clerk By R. B. Clifton, Deputy Clerk.

[Title of District Court and Cause.]

PRAECIPE

TO THE CLERK OF THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF CALIFORNIA:

You will please incorporate in the transcript of the record on appeal to the Circuit Court of Appeals for the Ninth Circuit, in the above entitled cause, the following, omitting therefrom all affidavits of personal service or service by mail, acknowledgments of service, and endorsements, except the dates of filing.

1. Amended Bill of Complaint
2. Stipulation for Filing of Amended Bill of Complaint
3. Answer of Defendant T. E. Klipstein
4. Amendment to the Answer of the Defendant T. E. Klipstein
5. Stipulation to Set for Trial
6. Trial Brief of Defendant Klipstein, submitted in lieu of oral argument, omitting therefrom everything except the date of filing and the following designated portions thereof, to-wit:

"There was a complete failure of proof necessary to entitle complainant to a recovery against defendant Klipstein."

****

"There was no proof that defendant Klipstein received anything by reason of any transaction in question, and in fact the proof showed affirmatively that he was the loser by such transactions of more than $5,000.00."

****

"There was no proof that defendant Klipstein was a de jure director of the bankrupt, and there was insufficient proof to hold him as a de facto director."

****

"Complainant is estopped from asserting that defendant Klipstein is liable on the causes of action stated."

****

"Defendant Klipstein therefore asks this Court to declare by its judgment that neither in equity or law has the complainant the right to recover any part of the moneys by him claimed."

7. Minute Order of December 4th, 1937
8. Findings of Fact and Conclusions of Law (including interlineations in long-hand)
9. Decree (including interlineations in long-hand)
10. Order to Show Cause
11. Minute Order of April 2nd, 1938.
12. Petition for Appeal and Order Allowing Appeal
13. Assignment of Errors
14. Undertaking on Appeal
15. Stipulation for Order of Severance
16. Order of Severance

17. Statement of Evidence and Order Settling Statement of Evidence
18. Citation on Appeal
19. Stipulation of May 24, 1938, regarding certain omissions from transcript on appeal
20. This Praecipe, with admission of service

You will please print a total of forty (40) copies of said transcript on appeal.

Homer Johnstone
Sidney H. Wyse
Attorneys for defendant and appellant
T. E. Kilstein

[Endorsed]: Receipt of copy is hereby acknowledged this 25th day of July, 1938. A. L. Shannon C. A. Shuey Attorneys for plaintiff and appellee, Herbert P. Sears. Filed Aug. 2 - 1938. R. S. Zimmerman, Clerk By L. B. Figg, Deputy Clerk.

[Title of District Court and Cause.]

CLERK'S CERTIFICATE.

I, R. S. Zimmerman, clerk of the United States District Court for the Southern District of California, do hereby certify the foregoing volume containing 97 pages, numbered from 1 to 97, inclusive, to be the Transcript of Record on Appeal in the above entitled cause, as printed by the appellant, and presented to me for comparison and certification, and that the same has been compared and corrected by me and contains a full, true and correct copy of the citation; stipulation for filing of amended bill of complaint; amended bill of complaint; answer of T. E. Klipstein; answer of Lew O. Stelzner; stipulation to set for trial; amendment to answer of T. E. Klipstein; trial brief of Klipstein, summary of points discussed; order of December 4, 1937 finding for plaintiff; findings of fact and conclusions of law; decree; order to show cause; order of April 2, 1938 modifying decree, etc.; statement of evidence; stipulation for order of severance; petition for appeal and order allowing appeal; assignment of errors; undertaking on appeal from a money judgment and for costs; stipulation; praecipe for appellee; praecipe for appellant.

DO FURTHER CERTIFY that the amount paid for printing the foregoing Record on Appeal is $ and that said amount has been paid the printer by the appellant herein and a receipted bill is herewith enclosed, also that the fees of the Clerk for comparing, correcting and certi-

fying the foregoing Record on Appeal amount to $
and that said amount has been paid me by the appellant herein.

IN TESTIMONY WHEREOF, I have hereunto set my hand and affixed the Seal of the District Court of the United States of America, in and for the Southern District of California, Central Division, this................ day of September, in the year of Our Lord One Thousand Nine Hundred and Thirty-eight and of our Independence the One Hundred and Sixty-third.

R. S. ZIMMERMAN,
Clerk of the District Court of the United States of America, in and for the Southern District of California.

By

Deputy.

No. 8994.

In the United States Circuit Court of Appeals

For the Ninth Circuit.

[T]. E. KLIPSTEIN,

Appellant,

vs.

[H]ERBERT P. SEARS, Trustee in Bankruptcy of the Estate of Globe Drug Company, Inc.,

Appellee.

APPELLANT'S OPENING BRIEF.

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No. 8994.

In the United States Circuit Court of Appeals

For the Ninth Circuit.

T. E. KLIPSTEIN,

Appellant,

vs.

HERBERT P. SEARS, Trustee in Bankruptcy of the Estate of Globe Drug Company, Inc.,

Appellee.

APPELLANT'S OPENING BRIEF.

BASIS OF JURISDICTION.

The basis on which it is contended that the District Court had jurisdiction, as disclosed by complainant's amended bill [Tr. p. 5], is section 70(e) of the National Bankruptcy Act (Act of July 1, 1898, c. 541, §70(e), 30 Stat. 565, as amended by Act of Feb. 5, 1903, c. 487, §16, 32 Stat. 800, U. S. C. A. (1928), Title 11, §110(e). This appeal is from a final decree entered in a suit in equity before the District Court for the Southern District of California. [Tr. p. 32.]

STATEMENT OF THE CASE.

This is a separate appeal by the defendant T. E. Klipstein from a final decree in a suit in equity brought by the complainant Sears, as trustee of the estate of Globe Drug Company, Inc., bankrupt, to compel the defendant Lew O. Stelzner and the defendant and appellant T. E. Klipstein to account for moneys alleged to have been illegally diverted from the corporation.

Complainant's amended bill [Tr. p. 5] alleged that at all times since 1928 Globe Drug Company, Inc., was a duly organized California corporation of which defendants Stelzner and Klipstein were stockholders, directors and officers; that in 1928 Stelzner and Klipstein borrowed $17,000.00 from Bank of America on their joint promissory note and used the proceeds to purchase certain outstanding shares of the corporation; that from that time until October 19, 1935, at least $12,200.00 was paid from corporate funds upon the note, for which payments the corporation received no consideration; that during this period the corporation owed various sums to various creditors and was insolvent and that such payments were made for the purpose of hindering, delaying and defrauding creditors; that on October 19, 1935, the balance unpaid on the note was $4,800.00 and that on that day Stelzner and Klipstein, as directors and officers, executed a promissory note of the corporation to the bank in said amount; that Klipstein thereupon purchased the corporate note from the bank and brought an action against the corporation in which a default judgment was allowed to be entered and all of the assets of the corporation, of the value of $5,000.00, sold at public auction by the sheriff; that said suit and sale were effected for the purpose of hindering, delaying and defrauding creditors; that the corpora-

tion was adjudicated a bankrupt in April, 1936; that Sears was appointed trustee of its estate on April 18, 1936; that creditors have proved their claims in the bankruptcy proceedings and that the assets of the estate are insufficient to pay such claims in full.

Defendant Stelzner, answering separately [Tr. p. 16], admitted that he had personally borrowed the money from the bank and had used the same to purchase stock of the corporation; alleged that Klipstein had endorsed Stelzner's note to the bank for the accommodation of Stelzner, who caused the stock purchased to be issued to Klipstein as security; admitted that payments were made as alleged on the note but denied that the corporation was insolvent at such times; admitted that suit had been brought by Klipstein and a sale held, but alleged that the reasonable value of the stock of goods sold was $1,900.00; denied that any actions were taken by either Stelzner or Klipstein with the intent to hinder, defraud or delay creditors.

Klipstein, also answering separately [Tr. p. 11; also p. 21], admitted that the corporation *had filed its articles* but denied that it was otherwise at any time duly organized or existing; denied that Klipstein was ever a stockholder, director or officer of the corporation; admitted the bankruptcy and the appointment of Sears as trustee; admitted the loan from the bank *to Stelzner* but denied that any part thereof was received by Klipstein, or that any stock was purchased for him; alleged that Klipstein signed the note as an accommodation party only and *received no consideration at any time for his signature;* admitted that certain payments were made on the note, the amounts of which were unknown to him, but denied that the payments were made from corporate funds; denied that the purported corporation had creditors and denied

that the purported corporation was insolvent at the time of making any such payments; denied that the drug company received no consideration for such payments; denied that such payments were made for the purpose of hindering, delaying or defrauding creditors; admitted that a note was given by the purported corporation to the bank on October 19, 1935; admitted that a suit was brought by Klipstein against the corporation but denied that said suit was brought for any fraudulent purpose and denied that the assets sold were of the value of $5,000.00; denied that the corporation was insolvent on October 19, 1935; denied for lack of information and belief that the corporation had creditors still unpaid and that there were insufficient assets to pay such creditors in full; pleaded the statute of limitations and alleged that Sears was estopped from any claim against Klipstein.

The suit was tried by the court, a jury having been waived, upon the issues raised by the amended bill and the respective answers of the defendants Stelzner and Klipstein. At the trial the only evidence introduced by complainant was the testimony of Stelzner, C. H. Landes (an officer of Bank of America) and Richard A. Pawson (a representative of a creditor of the corporation), and certain exhibits. On behalf of the defendants there was produced the testimony of Klipstein and Sears and several exhibits. There were no conflicts in the evidence, which undisputedly shows the following state of facts:

Articles of Incorporation of Globe Drug Company, Inc., were filed with the Secretary of State of the state of California on July 17, 1920, by Stelzner, V. J. Moore and James F. Brazill. The authorized capital stock of the corporation was 25,000 shares of a par value of $1.00 per share. The board of directors was to consist of three (3) members. [Tr. pp. 52-53.]

No permit to issue any such shares was at any time granted to the corporation by the Commissioner of Corporations of the state of California. [Tr. pp. 57, 64.]

Some time prior to January 3, 1928, an agreement was reached among Stelzner, Moore and one G. D. Holmquist, the then sole stockholders, by which Stelzner was to buy out the interests of Moore and Holmquist for the sum of $17,000.00. Klipstein, Stelzner's brother-in-law, agreed to aid Stelzner in raising the necessary funds. [Tr. pp. 55, 60.]

On January 3, 1928, the sum of $17,000.00 was borrowed by Stelzner from Bank of America, at Bakersfield. A note for that amount was signed and Klipstein affixed his signature to the note as an accommodation maker. [Tr. pp. 55, 57.] The stock held by the other parties was purchased by Stelzner and the certificates placed in the name of Klipstein. [Tr. p. 55.] At the same time proceedings were held to make Klipstein an officer and director of the drug company. At stockholders and directors meetings on December 31, 1927, Klipstein was purportedly elected a director and vice-president, and at a directors meeting on January 4, 1928, purportedly elected secretary. [Tr. p. 53.] Klipstein never at any time received any consideration for placing his signature on the note. [Tr. pp. 57, 60.]

No meetings of directors or stockholders were held for the next ensuing seven years, that is between January 23, 1928, and October 19, 1935. [Tr. pp. 53, 62.] During this period Stelzner was in sole charge of the drug store and Klipstein, who was in the title business, took no part and had no interest therein. [Tr. pp. 57, 60.] Between these dates payments of principal and interest on the loan were made by Stelzner to the bank. All such payments,

with the exception of $500.00 paid in 1934, were made from the funds of the drug company, which received no consideration therefor. [Tr. pp. 55, 61.] On each of the dates when any such payment was made the drug company was indebted to McKesson & Robbins, a wholesale drug concern, in at least the amount paid on the principal of the loan, on open credit account. [Tr. pp. 48-51.]

On October 19, 1935, the balance due on the principal of the loan was $4,800.00. [Tr. p. 44.] Several months prior to this date Klipstein first learned that Stelzner had unpaid creditors. [Tr. p. 60.] Klipstein thereupon consulted his attorneys at Bakersfield as to what should be done. [Tr. p. 62.] Pursuant to their advice the following steps were taken. On October 19, 1935, Klipstein demanded that the drug company execute a note to the bank in the sum of $4,800.00. A meeting was held on that day and the note was authorized, executed and delivered to the bank. Klipstein thereupon delivered his personal note in such amount to the bank in exchange for the drug company's note, which personal note was subsequently paid in full by Klipstein from his personal funds. [Tr. pp. 60-63.]

A suit was immediately commenced by Klipstein against the drug company for the amount of the note and $500.00 which he had paid to the bank in 1934. [Tr. p. 56.] This action was brought without prior notice to Stelzner for the purpose of preventing a further loss to the drug company, which at the time was unable to pay its rent, had a depleted stock and was losing money from day to day. [Tr. pp. 56, 61.]

Stelzner, believing there was no defense, defaulted. [Tr. p. 56.] Judgment was entered, execution issued and the stock and fixtures, which prior to the sale had been

appraised by a druggist at $2,200.00, were sold at public sale by the sheriff to Mr. Vest, an outsider, for $1,935.00. [Tr. pp. 58, 61.] The proceeds of the sale, less costs and expenses, were held by Klipstein's attorneys for the benefit of creditors and subsequently paid to Sears. [Tr. p. 58.] Creditors were notified of the proceedings by letters sent by Sears to the Board of Trade at San Francisco and the Los Angeles Wholesalers' Board of Trade. [Tr. pp. 64-65.] Klipstein instructed his attorneys to file a claim based on this judgment in the bankruptcy proceedings and to waive the claim at the meeting of creditors. [Tr. p. 61.]

During all of the period in consideration, and at the trial, Klipstein was unable to recognize the legal distinction between Stelzner as an individual and the drug company as a corporate entity. Klipstein regarded himself as a creditor of the corporation as well as of Stelzner and considered the judgment against the drug company as a judgment against Stelzner. [Tr. pp. 61-63.] Stelzner shared this belief. [Tr. p. 56.]

Globe Drug Company, Inc., was adjudicated a bankrupt on March 6, 1936, and Sears appointed trustee of its estate on April 18, 1936. This suit was commenced on October 20, 1936.

After trial by the court a decision in favor of Sears was announced by minute order made on December 4, 1937 [Tr. p. 24], and on December 29, 1937, the court made special findings and entered its decree [Tr. pp. 26-33], which decree was modified by a further order made on April 2, 1938. [Tr. pp. 36-37.] Stelzner has not appealed. [Tr. p. 68.]

This appeal was taken by Klipstein from the decree of the trial court, as amended. Being an equity appeal the

whole case is before the appellate court for decision on the merits, giving due weight to the findings of fact made by the trial judge. More particularly the questions to be considered arise from the exceptions taken below to (1) the findings of fact on the ground that certain designated and material findings are unsupported by any substantial evidence, (2) to the decree on the ground that it is unsupported by the evidence and the findings and (3) to the decree on the ground that such decree is void upon its face. These objections were made to the trial court and the fact thereof noted by the allowance of exceptions to the findings of fact and conclusions of law at the foot thereof and a further allowance of exception noted at the foot of the decree, as amended.

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SPECIFICATIONS OF ERRORS RELIED UPON.

Assigned Error No. XII [Transcript page 79]
Assigned Error No. XIII [Transcript page 80]
Assigned Error No. XIV [Transcript page 80]
Assigned Error No. XV [Transcript page 81]
Assigned Error No. XVI [Transcript page 82]
Assigned Error No. XVII [Transcript page 83]
Assigned Error No. XVIII [Transcript page 83]
Assigned Error No. XXI [Transcript page 85]
Assigned Error No. XXIV [Transcript page 87]
Assigned Error No. XXV [Transcript page 88]
Assigned Error No. XXVII [Transcript page 88]

SUMMARY OF ARGUMENT.

A. The appellate court in an appeal from a decree entered in an equity suit has before it both the facts and the law. It may consider the evidence supporting the findings and decree and may finally dispose of the case in accordance with its view of such evidence. Due weight is to be given to the findings made by the trial court but the appellate court is not bound by the findings, when clearly contrary to the weight of the evidence. This is true even in cases where there is substantial evidence in support of such findings.

B. There is no substantial evidence to support, in whole or in part, certain material findings of fact made by the trial court. Such findings are:

1. Finding of Fact. No. III [Tr. p. 27]
2. Finding of Fact No. IV [Tr. p. 27]
3. Finding of Fact No. II [Tr. p. 26]
4. Finding of Fact No. VIII [Tr. p. 29]
5. Findings of Fact Nos. V, VI and VII [Tr. pp. 28-29], considered as a group.

C. Complainant's substantive rights under the cause of action asserted in his amended bill are governed exclusively by the statutes and decisions of the state of California.

1. The evidence does not support the decree under the California law relating to fraudulent transfers for the

reasons that (a) there is no evidence of a transfer within the meaning of such law, (b) there is no evidence and no finding of actual fraud on the part of Klipstein, and (c) there is no evidence that the drug company was insolvent at any time prior to the date of the adjudication in bankruptcy.

2. The evidence does not support the decree under the California law relating to the liabilities of directors and officers of corporations for the reasons that (a) the undisputed evidence shows that Klipstein was never a *de jure* officer or director of the drug company and there is no substantial evidence that he was a *de facto* officer or director, and (b) there is no evidence that there were creditors existing at the time of the alleged transfers whose claims equal the amount of the decree and are still unpaid.

D. The decree is not supported by the findings in that there is no finding that any creditors have proved their claims in the bankruptcy proceedings and remain unpaid.

E. The decree entered is void in that the extent of Klipstein's liability is made thereby to depend upon a report made by a referee in a proceeding in which Klipstein is not represented and has no standing to dispute the propriety of any items in such report.

ARGUMENT.

The appellate court in an appeal from a decree entered in an equity suit has before it both the facts and the law. It may consider the evidence supporting the findings and decree and may finally dispose of the case in accordance with its view of such evidence. Due weight is to be given to the findings made by the trial court but the appellate court is not bound by the findings, when clearly contrary to the weight of the evidence. This is true even in cases where there is substantial evidence in support of such findings.

This action is in equity and was so pleaded and tried. The scope of the appellate court's review on an appeal from a final decree entered in an equity action has been stated by the Supreme Court in the case of *Keller v. Potomac Electric Power Company*, 261 U. S. 428, 43 S. Ct. 445 (1923), to be as follows:

> "In that (equity) procedure, an appeal brings up the whole record and the appellate court is authorized to review the evidence and make such order or decree as the Court of first instance ought to have made, giving proper weight to the findings on disputed issues of fact which should be accorded to a tribunal which heard the witnesses."

In accord with this statement are the cases of:

Presidio Mining Company v. Overton, 270 Fed. 388 (C. C. A. 9th, 1921);

Title Guarantee & Trust Company v. United States, 50 Fed. (2d) 544 (C. C. A. 9th, 1931);

Johnson v. Umsted, 64 Fed. (2d) 316 (C. C. A. 8th, 1933);

Aro Equipment Corporation v. Herring-Wissler Company, 84 Fed. (2d) 619 (C. C. A. 8th, 1936).

This rule has not been changed by the adoption, in 1930, of Equity Rule 70½, requiring the separate statement of findings of fact and conclusions of law. The effect of the new equity rule is merely to give the findings made by the trial court on disputed questions of fact the presumption of correctness. See *Broughton & Wiggins Navigation Company v. Hammond Lumber Company,* 84 Fed. (2d) 496 (C. C. A. 9th, 1936), construing the identically worded admiralty rule (Admiralty Rule 46½); *Hyland v. Miller's National Insurance Company,* 91 Fed. (2d) 735 (C. C. A. 9th, 1937).

Due to the undisputed character of all of the testimony in the case at bar this court is free to make whatever disposition of the cause appears to it just, accepting or rejecting the theories indulged in by the trial court. The basis of that court's decision is disclosed in its order directing judgment for plaintiff in which it "finds in favor of the plaintiff and (upon the authority of *In re Wright Motor Company* (C. C. A. 9th, 1924), 299 Fed. 106) orders a decree, etc." [Tr. p. 24.]

In so doing the court, as appellant respectfully contends, indulged in either one or the other of the following untenable theories, namely:

(a) that the question involved was one of general law as to which the court was not bound by the statutes and decisions of the state of California, or

(b) that the law of California had remained unchanged since the date of the *Wright Motor Company* case (1924) and that under such law complainant was not required to establish by evidence such material facts as the insolvency of the drug company at any time prior to its adjudication in bankruptcy or the existence of creditors still unpaid whose claims antedate the alleged withdrawals.

It may be noted in passing that the order referred to was entered on December 4, 1937, prior to the overruling of *Swift v. Tyson,* 41 U. S. 1, 10 L. Ed. 865 (1842), by the decision of the Supreme Court of the United States in *Erie Railroad Company v. Tompkins*, 304 U. S. 64, 58 S. Ct. 817, decided in April of 1938. The *Erie Railroad Company* case has the result of rendering decisions of the federal courts on general law questions no longer authoritative and limits the substantive law administered by such courts to the substantive law of the state in which the particular cause arose. As will be pointed out in this brief the applicable California laws were not followed in deciding this case. In addition to the wholly different factual set-up involved in the *Wright Motor Company* case the statutory and constitutional provisions upon which that case was based had been entirely changed before the occurrence of events involved in the case at bar.

Assignment of Error No. XIII.

There is no substantial evidence to support finding of fact No. III, upon the issues raised by the amended bill, paragraph III [Tr. p. 6], and Klipstein's answer, paragraph III [Tr. p. 11], assigned as error on this appeal as follows [Tr. p. 80]:

> "The Court erred in making and entering its Finding of Fact Number III, as follows:
>
> 'That on January 3, 1928, the defendants Lew O. Stelzner and T. E. Klipstein borrowed the sum of $17,000.00 from the Bank of America, and in consideration of such loan executed to such bank their personal joint and several promissory note for the same; that said sum of $17,000.00 was thereupon used by said defendants for the purpose of purchasing certain issued and outstanding shares of said Globe Drug Company, Inc., for their own personal and individual accounts.'; to which said finding an exception in favor of defendants was duly allowed and noted at the foot of the Findings of Fact and Conclusions of Law.
>
> For the reason that there is no competent evidence in the record to support such finding."

There is no evidence whatever that Klipstein ever borrowed the sum of $17,000.00 or any other sum from Bank of America or that Klipstein ever used any money borrowed by Stelzner or anyone else from the bank for the purpose of purchasing shares of Globe Drug Company, Inc., for his account. The evidence indisputably shows that the sum mentioned was borrowed by Stelzner, that Stelzner purchased the stock, that Klipstein's signature on the note at the bank was made for accommodation

only and that the shares purchased were placed in Klipstein's name as security only.

Mr. Landes, an officer of the bank, called as a witness by Sears, testified that the bank records showed a loan to Stelzner, evidenced by a note "endorsed or secured" by the signature of Klipstein. [Tr. p. 39.] Photostatic copies of the bank records in question, introduced into evidence as Plaintiff's Exhibit 3 [Tr. p. 44], corroborate Mr. Landes and show that the loan account was carried in the name of Stelzner only and that in the margin of said account there was a notation that the account was "endorsed or secured" by Klipstein.

Stelzner testified that the note was signed by Klipstein as a personal accommodation to Stelzner and that Klipstein never received any part of the money borrowed or anything else for his accommodation. [Tr. p. 57.] Concerning the purchase of the stock Stelzner testified that "I received the proceeds of said loan and used the same to buy the stock * * *" [Tr. p. 55], and Stelzner subsequently referred to the shares as "the stock that I bought." [Tr. p. 56.]

Klipstein testified that in 1928 he "aided" Stelzner in procuring the money from the bank "to buy out his partners." [Tr. p. 60.] Klipstein further testified that the money was received by Stelzner and that Klipstein never at any time received any consideration of any kind for placing his name on the note. [Tr. p. 60.]

This was the only evidence produced on the issue as to the intention of the parties in regard to the stock placed in the name of Klipstein on the books of the drug company. It is perfectly obvious that the stock purchased was purchased by Stelzner from money which Stelzner borrowed, that Klipstein's entire connection with the trans-

action was in the character of a guarantor and that the stock was put in his name for security only, as alleged in Stelzner's answer. [Tr. p. 16.] There was no evidence nor can the inference be drawn from any evidence in the record that it was ever at any time the intention of either Stelzner or Klipstein that Klipstein should be beneficially interested to any extent in the shares purchased.

Assignment of Error No. XIV.

There is no substantial evidence to support finding of fact No. IV upon the issues raised by the amended bill, paragraph IV [Tr. p. 6], and Klipstein's answer, paragraph IV [Tr. p. 12], assigned as error on this appeal as follows [Tr. p. 80]:

> "The Court erred in making and entering its Finding of Fact Number IV, as follows:
>
> 'That during the period of time from the execution of said note up to October 19, 1935, various payments were made on account of the principal and interest of said note, aggregating a sum in excess of $12,200.00; that all of such payments were made by, and directly from and with the funds of, said corporation; that at each and all of the times when said payments were made as aforesaid, said corporation owed various sums of money to various creditors, such indebtedness at such times being in excess of the amounts of such respective payments; that no consideration whatsoever was ever received by said corporation for or in connection with any of said payments; that for a period of at least three years prior to the date of its adjudication in bankruptcy, said corporation was in an insolvent condition; that

the payments made by said corporation on the personal note of said defendants during said three-year period aggregated a sum of at least $4,255.54; that each and all of said payments were made as aforesaid with the purpose and intent on the part of said corporation, and of said defendants, of hindering, delaying, and defrauding the creditors of said corporation.'; to which said finding an exception in favor of defendant was duly allowed and noted at the foot of the Findings of Fact and Conclusions of Law.

For the reason that there is no competent evidence in the record to support such finding."

The only evidence in the record in any way bearing upon the finding "that at each and all of the times when said payments were made as aforesaid, said corporation owed various sums of money to various creditors, such indebtedness at such times being in excess of such respective payments;" is the testimony of Mr. Pawson, assistant credit manager of McKesson & Langley, who prepared lists [Complainant's Exhibit 4, Tr. p. 48], showing the debit balance of Globe Drug Company, Inc. on the books of McKesson & Langley on the various dates when payments of principal and interest were made to the bank. [Tr. p. 45.] The testimony and the exhibit shows only that the drug company during a period of some seven and a half years maintained an open credit account with *one* wholesale drug concern and that the average balance in said account during that period was around $1,000.00. There is no evidence in the record that the drug store had any other creditors during this period, so that the finding that there were "various creditors" is absolutely unsupported. This lack of evidence is very important to appel-

lant because appellee's rights in this action are limited to the rights of creditors whom he represents. *Davis v. Willey,* 273 Fed. 397 (C. C. A. 9th, 1921).

Sears pleaded in his amended bill that the drug store was insolvent from date of the execution of the note (January 3, 1928) to October 19, 1935 [paragraph IV, Tr. p. 6], which allegation was specifically denied by Klipstein in his answer. [Paragraph IV, Tr. p. 12.] The court found that "for a period of at least three years prior to the date of its adjudication in bankruptcy, said corporation was in an insolvent condition."

There is an absolute lack of evidence to sustain any such finding. The only proof in the record in any way relevant to this issue is: (1) Mr. Pawson's testimony that the drug store was indebted to McKesson & Langley on open account during the entire period [Tr. p. 45]; (2) Klipstein's admission in his answer [paragraph I, Tr. p. 11], of complainant's allegation in its amended bill [paragraph I, Tr. p. 5] that Globe Drug Company, Inc., was adjudicated a bankrupt in the month of April, 1936; and (3) Klipstein's testimony that he first learned that there were "unpaid creditors" [Tr. p. 60], a few months prior to the filing of the Kern County action, *i. e.*, prior to October 19, 1935. [See Complainant's Exhibit 7, Tr. p. 56.]

There is no further evidence bearing in any way upon the financial standing of the company at any time during the period of the withdrawals. This evidence without more is obviously insufficient to establish the fact of insolvency for any three-year or other period prior to the date of the adjudication in bankruptcy.

Appellant will not here argue the sufficiency of the evidence to support the finding that "each and all of said payments were made as aforesaid with the purpose and

intent on the part of said corporation and of said defendants, of hindering, delaying and defrauding the creditors of said corporation." It is appellant's contention in this regard that this and certain other findings containing similar language must be interpreted in view of the findings as a whole in order to determine the intent of the trial court in making such findings. Appellant will therefore reserve his argument on this point for a later part of his brief.

Assignment of Error No. XII.

There is no substantial evidence to support finding of fact No. II, on the issues raised by the amended bill, paragraph II [Tr. p. 6], and the amendment to Klipstein's answer, paragraph I [Tr. p. 21], assigned as error on this appeal as follows [Tr. p. 79]:

> "The Court erred in making and entering its Finding of Fact Number II as follows:
>
> 'That at all times herein mentioned said Globe Drug Company, Inc., was a corporation duly organized and existing under and by virtue of the laws of the State of California; that ever since January 3, 1928, the defendant Lew O. Stelzner was a stockholder, the president and one of the members of the Board of Directors of said corporation and the defendant T. E. Klipstein was a stockholder, the secretary, and one of the members of the Board of Directors of said corporation.';
>
> to which said finding an exception in favor of defendant was duly allowed and noted at the foot of the Findings of Fact and Conclusions of Law.
>
> For the reason that there is no competent evidence in the record to support such finding."

The point raised in this assignment of error will be discussed at some length *infra* in the argument addressed to the question of the propriety of the decree under the California law relating to liabilities of directors and officers of corporations.

In view of the evidence of Stelzner [Tr. p. 57] and the Commissioner of Corporations [Tr. p. 64] that no permit to issue stock was ever procured, Klipstein never became a *de jure* director or officer under the California law then in effect.

> *General Laws of California* (Deering, 1923), Act 3814, Sec. 12;
>
> *Klinker v. Guarantee Title Co.,* 98 Cal. App. 469, 277 Pac. 177 (1929);
>
> *Regan v. Albin,* 219 Cal. 357, 26 Pac. (2d) 475 (1933).

Moreover there was no evidence whatever of any acts which might make Klipstein a *de facto* officer during the period of the withdrawals. The first payment to the bank was on April 3, 1928 [Tr. p. 41], the last on August 9, 1935. [Tr. pp. 40, 42.] There is absolutely no evidence that Klipstein ever attended any meeting, or signed any documents, or authorized or consented to any withdrawal, or otherwise in any manner whatsoever took any part in the management or business of the drug store from January 23, 1928, to October 19, 1935. There is therefore no evidence of any kind from which it could be inferred that Klipstein was a *de facto* officer or director of the corpora-

tion during any part of the period in which the acts complained of occurred.

> "One in actual possession of an office under claim and color of election or appointment, and *continually exercising its functions and discharging its duties*, is an officer *de facto*."
>
> Fletcher, Cyclopedia of Corporations (Perm. Ed. 1931), Vol. 2, p. 145.

Assignment of Error No. XVIII.

There is no substantial evidence to support finding of fact No. VIII, upon the issues raised by the amended bill, paragraph II [Tr. p. 9] and Klipstein's answer, paragraph X [Tr. p. 13], assigned as error on this appeal as follows [Tr. p. 83]:

> "The Court erred in making and entering its Finding of Fact Number VIII, as follows:
>
> 'That the payments made out of said corporation's funds as aforesaid, were authorized and consented to by the defendants while they were acting as officers and directors of said corporation, and while they were stockholders thereof; that said payments were not made out of surplus or net profits of said corporation, nor was said corporation then in the process of winding up or dissolution; that said payments were made without the vote or written consent of any of the shares of said corporation other than the shares held by the defendants; that no permit of the Commissioner of Corporations of the State of California was ever applied for or issued authorizing such payments'; to which said finding an exception in favor of de-

fendant was duly allowed and noted at the foot of the Findings of Fact and Conclusions of Law.

For the reason that there is no competent evidence in the record to support such finding."

There is not one word of evidence that Klipstein ever "authorized" or "assented to" any withdrawal of corporate funds, or that he even knew or suspected the source from which Stelzner procured the money to pay the bank. Neither was there any word of evidence from which a finding could be made that such payments were not made from net surplus. It is impossible for any court to say, on the record in this case, at what time, if ever, the capital stock of the drug company became impaired prior to October, 1935. In these respects finding of fact No. VIII is absolutely and completely unsupported.

Assignments of Error Nos. XV, XVI & XVII.

There is no substantial evidence to support findings of fact Nos. V, VI and VII upon the issues raised by the amended bill, paragraphs V, VI and VII [Tr. pp. 7, 8], and Klipstein's answer, paragraphs V, VI and VII [Tr. p. 12], assigned as errors on this appeal as follows [Tr. pp. 81-83]:

Assignment of Error No. XV.

"The Court erred in making and entering its Finding of Fact Number V, as follows:

'That on or about October 19, 1935, there remained unpaid on the principal of said promissory note a balance of $4,800.00; that on or about said date defendants, acting as directors and officers of said corporation, caused to be executed to said Bank of

America the promissory note of said corporation in the sum of $4,800.00; that said note was thereupon accepted by said bank in payment of the balance due on said promissory note of the defendants; that said corporation received no consideration for the execution of said note; either directly or indirectly.';

to which said finding an exception in favor of defendant was duly allowed and noted at the foot of the Findings of Fact and Conclusions of Law.

For the reason that there is no competent evidence in the record to support such finding."

Assignment of Error No. XVI.

"The Court erred in making and entering its Finding of Fact Number VI, as follows:

'That shortly after the execution of said last mentioned promissory note, the defendant Klipstein purchased the same from said bank and thereupon, and on October 19, 1935, commenced an action in the Superior Court of the State of California, in and for the County of Kern, to recover from said corporation the amount alleged by him to have been so paid in the purchase of said note; that thereafter the
illegally and without right or cause [LRY]
defendants, ~~fraudulently~~ permitted said corporation to suffer a default judgment to be entered in said action against it for the sum of $5,364.00; that thereafter execution was issued on said judgment, pursuant to which all of the properties and assets of said corporation were sold at public auction by the sheriff of said county.';

to which said finding an exception in favor of defendant was duly allowed and noted at the foot of the Findings of Fact and Conclusions of Law.

For the reason that there is no competent evidence in the record to support such finding."

Assignment of Error No. XVII.

"The Court erred in making and entering its Finding of Fact Number VII, as follows:

'That at the time said action was commenced and said execution sale was effected as aforesaid, said corporation owed various sums of money to various creditors and was insolvent, and said action was commenced and prosecuted, such judgment was suffered to be taken, and said execution sale effected with the purpose and intent on the part of said corporation and the defendants of hindering, delaying, and defrauding the creditors of said corporation.';

to which said finding an exception in favor of defendant was duly allowed and noted at the foot of the Findings of Fact and Conclusions of Law.

For the reason that there is no competent evidence in the record to support such finding."

The three assignments of error above set out deal as a group with the action brought by Klipstein in the Superior Court of the state of California for Kern county. Most of the facts stated in these three findings are in accordance with the undisputed evidence produced. The finding that the corporations owed various sums of money to various creditors and was insolvent on the date that judgment was entered in that action has already been considered in connection with Assignment of Error No. XIV, *supra*. The finding that the sale was made for the purpose of hindering, delaying and defrauding creditors and the legal conclusion that the default was suffered "illegally and without

right or cause" will be considered below in connection with the question of intent expressed by the findings as a whole.

Appellant desires to raise the question of these three assignments of error as a group because they relate to a phase of the case that is absolutely irrelevant to the relief granted by the trial court. It is appellant's belief that these findings are unsupported in the particulars above mentioned but that these findings whether supported or not have no bearing on the case. No one was injured by the execution of the corporate note—the note was never paid and was returned to the company. [Tr. p. 61.] No one was injured by the judgment—nothing was ever paid on it. [Tr. p. 62.] No one was injured by the execution sale—the proceeds were turned over to Sears, as trustee, and there is no hint in the record that the sales price was not absolutely fair. [Tr. pp. 58, 62.] As a matter of fact Klipstein's testimony that the creditors in fact benefited by the whole proceeding was undisputed. [Tr. p. 61.] Whether Klipstein had any right of action against the company depends on the law of *alter ego*. It is obvious that he believed he had such a right and Stelzner himself shared this belief. [Tr. pp. 63, 56.] Klipstein's action was undoubtedly taken as the result of poor advice by his then attorneys, who should have known that such a suit would appear improper to creditors even if brought for the purpose of preventing Stelzner from further depleting the assets of the corporation. Klipstein's good faith in the matter is conclusively shown, however, and since there is no evidence that the corporation was in any way injured the findings based on this phase of the case are irrelevant and unnecessary. Appellant does not believe that appellee will attempt to use any portions of such findings to sustain the decree. In fairness they should be stricken as needlessly coloring the record.

Complainant's substantive rights under the cause of action asserted in his amended bill are governed exclusively by the statutes and decisions of the state of California.

The jurisdiction of the court below was invoked, and could only be invoked, under section 70(e) of the National Bankruptcy Act as it existed at the time when suit was brought (Act of July 1, 1898, c. 541, §70(e), 30 Stat. 565, as amended by Act of Feb. 5, 1903, c. 487, §16, 32 Stat. 800, U. S. C. A. (1928), Title 11, §110 (e)). Diversity of citizenship was neither pleaded nor proved so that the claimed jurisdiction must rest within the exceptions, stated in section 23(b) of the Act, to the general rule that the trustee, except with the consent of the proposed defendants, may only sue in the federal courts in which the bankrupt could have sued had bankruptcy not intervened. See *Wood v. A. Wilbert's Sons Shingle & Lumber Company,* 226 U. S. 384, 33 S. Ct. 184 (1912). There is of course no question of consent in this case. [See Assigned Error No. I, Tr. p. 71.]

The only actions excepted from the general rule by the express provisions of section 23(b) are those brought for the recovery of property under sections 60(b), 67(e) and 70(e). Both 60(b) and 67(e) relate solely to actions brought to invalidate certain enumerated transactions occurring within four months of the bankruptcy. Since in the case at bar all transfers are conceded to have been made more than four months prior to the bankruptcy it is obvious that jurisdiction can only be sustained, if at all, under section 70(e). If appellee on this appeal should attempt to sustain the decree under any other section of the Bankruptcy Act he would automatically forfeit his right to claim that the court below had jurisdiction.

Section 70(e) of the National Bankruptcy Act, in effect during the entire period under consideration, was as follows:

> "e. The trustee may avoid any transfer by the bankrupt of his property which any creditor of such bankrupt might have avoided, and may recover the property so transferred, or its value from the person to whom it was transferred, unless he was a bona fide holder for value prior to the dates of the adjudication. Such property may be recovered or its value collected from whoever may have received it, except a bona fide holder for value. For the purpose of such recovery any court of bankruptcy as hereinbefore defined, and any State court which would have had jurisdiction if bankruptcy had not intervened, shall have concurrent jurisdiction."

It is well settled that this section does not confer upon the trustee in bankruptcy any substantive rights in addition to those which creditors would have possessed had bankruptcy not intervened. See:

Stellwagen v. Clum, 245 U. S. 605, 38 S. Ct. 215 (1918);

Davis v. Willey, 273 Fed. 397 (C. C. A. 9th, 1921);

Peter Barceloux Company v. Buffum, 61 Fed. (2d) 145 (C. C. A. 9th, 1932), reversed on other grounds *sub nom. Buffum v. Barceloux,* 289 U. S. 227, 53 S. Ct. 539 (1933).

In the case last cited the Circuit Court of Appeals states:

> ". . . it has been uniformly held that this provision (section 70e) of the Bankruptcy Act does not give any substantive right in cases of transfer made

more than four months before the institution of the bankruptcy proceeding, but merely authorizes the trustee to enforce the rights of creditors in accordance with the laws of the state applicable to the transaction."

Since all the transactions involved in this case took place entirely within the state of California and no extra-state contacts were involved, the rights of creditors seeking to secure the relief which the trustee is now asking depend upon the substantive law of the state of California as contained in its statutes and decisions. This would of course be true in any action brought by a creditor in the state courts and would be true as well in any similar action in the federal courts, which are bound to follow both the statutes and decisions of the state. (See Act of September 24, 1789, c. 20, §34, 1 Stat. 92, U. S. C. A. (1928), Title 11, §725; *Erie Railroad Company v. Tompkins,* 304 U. S. 64, 58 S. Ct. 817 (1938).)

Assignment of Error No. XXI. [Tr. p. 85.]

"The Court erred in making and entering its Conclusion of Law Number I, as follows:

'That all the payments made out of said corporation's funds as above described, were wrongfully and

[LRY] in law

illegally made, and were and are fraudulent ^ and void as to plaintiff.'

to which said conclusion of law an exception in favor of defendant was duly allowed and noted at the foot of the Findings of Fact and Conclusions of Law.

For the reason that such conclusion of law is not supported by the evidence or by the facts found."

Assignment of Error No. XXIV. [Tr. p. 87.]

"The Court erred in making and entering its decree, as amended, for the reason that there is no substantial evidence to sustain said decree."

The California law applicable to this case is contained in two groups of statutory provisions, together with the decisions of the California courts construing these provisions. These are, first, the provisions relating to the rights of creditors to set aside fraudulent transfers, and, second, the provisions relating to the liability to creditors of directors and officers of corporations. It is obvious that Sears' amended bill was drawn in two counts with this distinction in mind. The first count [Tr. pp. 5-8] alleges the transfer of funds from the bankrupt with intent to defraud creditors, made without consideration, while the bankrupt was insolvent. The second count [Tr. pp. 8-9] alleges a violation of the statutory duties of officers and directors of corporations.

The evidence does not support the decree under the California law relating to fraudulent transfers for the reasons that (a) there is no evidence of a transfer within the meaning of such law, (b) there is no evidence and no finding of actual fraud on the part of Klipstein, and (c) there is no evidence that the drug company was insolvent at any time prior to the date of the adjudication in bankruptcy.

The law of California relating to the rights of creditors to invalidate transfers made by a debtor is contained in sections 3439 and 3442 of the Civil Code, as follows:

"§3439. Every transfer of property or charge thereon made, every obligation incurred, and every judicial proceeding taken, with intent to delay or de-

fraud any creditor or other person of his demands, is void against all creditors of the debtor, and their successors in interest and against any person upon whom the estate of the debtor devolves in trust for the benefit of others than the debtor."

"§3442. In all cases arising under section twelve hundred and twenty-seven, or under the provisions of this title, except as otherwise provided in section thirty-four hundred and forty, the question of fraudulent intent is one of fact and not of law; nor can any transfer or charge be adjudged fraudulent solely on the ground that it is not made for a valuable consideration; provided, however, that any transfer or encumbrance of property made or given voluntarily, or without a valuable consideration, by a party while insolvent or in contemplation of insolvency, shall be fraudulent, and void as to existing creditors."

The elements of the creditors' cause of action as provided for in these sections is clear. There must occur, first, a transfer of a property right and, second, fraud, either actual or constructive, the latter being treated as a conclusive presumption resulting from a showing of no consideration plus insolvency. See, *Hopkins v. White,* 20 Cal. App. 234, 128 Pac. 780 (1912).

The first question to be considered is whether there is any evidence of a "transfer" within the meaning of the statutory provisions. There is no dispute as to the mechanics of the transactions in question. Corporate funds were paid out on corporate checks signed by Stelzner, to the order of the bank. [Tr. p. 43.] These funds were applied upon a personal indebtedness of Stelzner to the bank, for which Klipstein was secondarily liable as surety. [Tr. p. 44.]

For reasons best known to himself Sears has not sought to impose liability upon the real transferee of the corporate assets, the bank. Instead he seeks to hold Klipstein, who was scarcely more than an outsider in the whole transaction. The bank was the party primarily benefited in that the money borrowed from it was repaid. Stelzner benefited directly by the cancellation of his personal and primary obligation. Klipstein's benefit was wholly incidental in that the cancellation of Stelzner's primary obligation extinguished *pro tanto* Klipstein's contingent liability to pay the bank if Stelzner defaulted on an obligation created wholly for Stelzner's benefit. No money or property passed to Klipstein at the time of the original loan, or at the time of the asserted "transfers."

California decisions go further than the decisions in a majority of the other states in imposing liability upon a fraudulent transferee who has re-transferred the property received by him, on the theory that the proceeds of such re-sale create a trust fund. (See *Pedro v. Soares,* 18 Cal. App. (2d) 600, 64 Pac. (2d) 766 (1937), and cases cited therein.) But no California case known to appellant goes so far as to make liable a party who *has never had in his hands any cash or property transferred by the debtor.* This was the position of Klipstein. Even under the most liberal trust rules there was here no fund, no property nor anything else ever in the hands of Klipstein to which a trust might attach.

In addition to a transfer, the creditor invoking sections 3439 and 3442 must prove fraud, either actual under section 3439 or constructive under section 3442. Constructive fraud is shown when there is a lack of consideration for a transfer made at a time when the transferor is insolvent or contemplates insolvency, and renders the trans-

action void as to existing creditors only. Intent is here immaterial.

> *Atkinson v. Western Development Syndicate,* 170 Cal. 503, 150 Pac. 360 (1915);
>
> *Hanscome-James-Winship v. Ainger,* 71 Cal. App. 735, 236 Pac. 325 (1925).

Appellant does not believe that appellee will claim on this appeal that the trial court found Klipstein guilty of actual fraud under these statutory provisions. Actual fraud means an actual intent or design in the mind of Klipstein to prevent creditors of the corporation from reaching its assets.

> *Ross v. Sedgwick,* 69 Cal. 247, 10 Pac. 400 (1886);
>
> *Goldner v. Spencer,* 163 Cal. 317, 125 Pac. 347 (1912).

The court found that the payments made to the bank were made "with the purpose and intent on the part of said corporation, and of said defendants, of hindering, delaying, and defrauding the creditors of said corporation." [Finding of Fact No. IV, Tr. p. 28]; as to the suit by Klipstein against the drug company that "said action was commenced and prosecuted, said judgment was suffered to be taken, and said execution sale effected the purpose and intent on the part of said corporation and the defendants of hindering, delaying, and defrauding the creditors of said corporation." [Finding of Fact No. VII, Tr. p. 29.] *But* the court in Finding of Fact No. VI [Tr. p. 28] found not that the default judgment was fraudulently permitted to be entered but that this was done "illegally and without right or cause" and for its

general conclusion drawn from all of the findings of fact the court concluded "That all the payments made out of said corporation's funds as above described, were wrongfully and illegally made, and were and are fraudulent *in law* and void as to plaintiff." [Conclusion of Law No. I, Tr. p. 30.]

It is obvious that the findings and conclusions must be construed together in order to determine the intent of the trial court. That intent is clear from the phraseology of the findings and conclusions and from the only opinion rendered, that contained in the minute order of December 4, 1937, wherein the court held the defendants liable in the sum of $4,255.54," the same being the sums shown to have been illegally withdrawn and paid out by the defendants and for which they are liable to account to the plaintiff." [Tr. p. 25.]

A consideration of the law and the evidence will show indisputably that the trial court could not have intended to find otherwise on this issue. In the early case of *Dana v. Stanfords,* 10 Cal. 269 (1858), the Supreme Court of California stated:

> "To avoid the conveyance (i. e. on the ground of actual fraud), there must be a real design on the part of the debtor to prevent the application of his property, in whole or in part, to the satisfaction of his debts."

This language was cited and approved after the adoption of the codes in *Ross v. Sedgwick,* 69 Cal. 247, 10 Pac. 400 (1886).

All presumptions are against actual fraud and must be overcome by clear and convincing evidence before warranting a finding. *Levy v. Scott,* 115 Cal. 39, 46 Pac.

892 (1896). In the case of *Truett v. Onderdonk,* 120 Cal. 581, 53 Pac. 26 (1898), the court stated in this connection:

> "The presumption is always against fraud, a presumption approximating in strength to that of innocence of crime, and it should not be deemed overcome, even *prima facie,* upon a showing so intangible and shadowy."

It is sufficiently obvious that there is no proof in the record of this case sufficient to establish actual fraud under the stringent California requirements. In the first place the most Sears could possibly claim under any circumstances is that Klipstein should have known the source of the payments, should have determined their legal impropriety and should have taken active steps to prevent Stelzner from making further payments. There is no evidence whatsoever that Klipstein had any connection of any sort with the affairs of the corporation between January 23, 1928 and October 19, 1935. [Tr. pp. 53, 57, 62.] January 23, 1928, was *prior to the first payment* to the bank, and October 19, 1935, was *subsequent to the last payment.* [Tr. pp. 39-42.] There is not a word of testimony that Klipstein knew anything about the condition of the company during this period or that he even knew that the payments were being made from the company's funds. Indeed, from his belief in the identity of Stelzner and the company it is obvious that, had he known the source of the payments, in all probability he would have considered them perfectly proper. [Tr. p. 61.]

Under these circumstances no finding of actual fraud could have been made or contemplated in connection with the payments to the bank.

The same is true as to the findings relating to the suit and execution sale, already shown to be irrelevant to Sears' cause of action by reason of the fact that the corporation was in no way injured thereby. Klipstein's motives in this regard are clear and uncontradicted. He discovered the condition of Stelzner's business a few months prior to October, 1935. [Tr. p. 60.] He believed himself a creditor of the company as well as of Stelzner and he admitted that his actions were motivated by a desire to protect himself, as well as Stelzner and the other creditors. [Tr. p. 61.] If there had been the slightest desire on his part to obtain any secret advantage or *delay* creditors it is hardly conceivable that he would have caused a public sale, procured cash bidders, and have *notified* creditors of the proceedings through the local representative of the Los Angeles and San Francisco Boards of Trade who now prosecutes this action on behalf of the creditors, nor would he in addition have offered to yield the claim to which he considered himself entitled, for their benefit. [Tr. pp. 61, 63, 64-65.]

Klipstein was obviously ill-advised but his motives were entirely disclosed in his testimony and entirely consistent with the course of action which he pursued. As stated by the Supreme Court of California in *Levy v. Scott*, 115 Cal. 39, 46 Pac. 892 (1896):

> ". . . while there are circumstances in and of themselves unusual, or perhaps in their nature suspicious—circumstances upon which respondent builds a somewhat plausible 'theory' of collusion and fraud—these circumstances comport equally with the theory of honesty and fair-dealing. . . ."
>
> "It is quite true that evidences of fraud are not left lying patent in the sunlight; that fraud itself is

always concealed, and that the truth is to be discovered more often from circumstances, from the interests of the parties, from the irregularities of the transaction, coupled with injury worked to an innocent party, than from direct and primary evidence of the fraudulent contrivance itself. Nevertheless, the evidence of these matters, facts, and circumstances, taken together, must amount to proof of fraud, and not to a mere suspicion thereof, for the presumption of the law, except where confidential relations are involved, is always in favor of the fair-dealing of the parties."

There is one exception to the rule that actual fraud is essential in fraudulent transfer cases in California. This exception arises from the conclusive presumption created by section 3442 when there combine the elements of (1) a transfer without consideration (2) while the transferor is insolvent or contemplates insolvency. If these two elements are present the transfer is void as to existing creditors. Both elements must be pleaded and proved by the creditor.

Emmons v. Barton, 109 Cal. 662, 42 Pac. 303 (1895);

Bank of Willows v. Small, 144 Cal. 709, 78 Pac. 263 (1904);

Parkinson Brothers Company v. Figel, 24 Cal. App. 701, 142 Pac. 135 (1914);

Carcaga v. Moore, 70 Cal. App. 614, 234 Pac. 121 (1925);

Foster v. Foster, 123 Cal. App. 1, 10 Pac. (2d) 796 (1932);

Fross v. Wotton, 3 Cal. (2d) 384, 44 Pac. (2d) 350 (1935).

There was admittedly no consideration flowing to the corporation from the payments to the bank. [Tr. p. 56.] Proof of such lack of consideration is alone insufficient, however, and such proof does not cause the burden to shift to the defendants to prove solvency. In *Bank of Willows v. Small,* 144 Cal. 709, 78 Pac. 263 (1904), an action to cancel a deed alleged to have been delivered in fraud of creditors the court commented upon this question as follows:

> "It was necessary for plaintiff to show that it could not collect its claim from the estate of Julian, nor from other property of Nancy Small, before it could complain as to the deed. The deed would not have injured plaintiff if it could still collect the amount of its claim from other sources."

See, also:

Fross v. Wotton, 3 Cal. (2d) 384, 44 Pac. (2d) 350 (1935).

Here there is an entire lack of any proof of insolvency at any time prior to the actual adjudication in bankruptcy. This phase of the evidence has already been considered in the argument addressed to Finding of Fact No. IV and will not be here re-argued.

It is further evident that even if appellee had proved a case of constructive fraud any transfer within the statutory period would only be void as to *existing* creditors. This means as to creditors having claims at the time of the questioned transfer *which claims remain now unpaid.* In so far as any creditor has been paid he is not injured.

Any new advance would make him only a "subsequent creditor" who has no standing to attack the transaction.

Scales v. Holje, 41 Cal. App. 733, 183 Pac. 308 (1919).

See, also:

Globe Bank v. Martin, 236 U. S. 288, 35 S. Ct. 377 (1915).

The failure to prove the existence of such creditors has already been considered in the argument addressed to Finding of Fact IV and will be further considered *infra* with reference to the failure to find the fact that any creditor or creditors remains or remain unpaid.

The decree cannot therefore be sustained under the sections of the Civil Code above considered. Reiterating appellant's contentions briefly, there is no evidence of a "transfer," or of "actual fraud," or of insolvency necessary to create constructive fraud, or of existing creditors still unpaid whose claims total the amount of the decree. These failures of proof entail an entire failure to sustain a decree based upon the California law considered.

The evidence does not support the decree under the California law relating to the liabilities of directors and officers of corporations for the reasons that (a) the undisputed evidence shows that Klipstein was never a de jure officer or director of the drug company and there is no substantial evidence that he was a de facto officer or director, and (b) there is no evidence that there were creditors existing at the time of the alleged transfers whose claims equal the amount of the decree and are still unpaid.

The theory of Sears' second count is that Stelzner and Klipstein were guilty of violation of the law relating to liabilities to creditors of directors and officers of corporations. [Tr. p. 9.] The statutory provisions in this regard are contained in section 363 of the Civil Code, replacing former section 309. Inasmuch as section 363 and its predecessor have been subject to frequent amendment it is of exceeding importance to note the changes in the statutory provisions over the period of the existence of these sections in order properly to interpret the judicial decisions construing them.

Former section 309 was enacted as part of the Civil Code of California on March 21, 1872, and was based on Stats. 1850, p. 348; Stats. 1861, p. 607, section 50; Stats. 1865-66, p. 747, section 12; Stats. 1865-66, p. 757, section 13; Stats. 1861, p. 626, section 56; and Stats. 1853, p. 89, sections 13 and 14. Minor amendments were made in 1891 (Stats. and Amdts. 1891, p. 468) and 1905 (Stats. and Amdts. 1905, p. 558). As amended to and including 1905 (omitting immaterial portions) section 309 read as follows:

> "The directors of corporations must not make dividends except from the surplus profits arising from the business thereof; nor must they create any debts beyond their subscribed capital stock; nor must they divide, withdraw, or pay to the stockholders, or any of them, any part of the capital stock, except as hereinafter provided, nor reduce or increase the capital stock, except as herein specially provided. For a violation of the provisions of this section, the directors under whose administration the same may have happened (except those who may have caused their dissent therefrom to be entered at large on the minutes

of the directors at the time, or were not present when the same did happen) are, in their individual or private capacity, jointly and severally liable to the corporation, and to the creditors thereof, to the full amount of the capital stock so divided, withdrawn, paid out, or reduced, or debt contracted;"

Thereafter no amendments were passed until 1917, when certain provisions of the section were eliminated by Stats. and Amdts. 1917, p. 657. As so amended and in effect at the date of the incorporation of Globe Drug Company, Inc., section 309 read as follows (omitting immaterial portions):

"Unless they shall have been first permitted or authorized so to do by the commissioner of corporations, directors of corporations must not make dividends except from the surplus profits arising from the business thereof; nor must they create any debts beyond their subscribed capital stock; nor must they divide, withdraw, or pay to the stockholders, or any of them, any part of the capital stock, except as hereinafter provided, nor reduce or increase the capital stock, except as provided in section three hundred fifty-nine of this code. For a violation of the provisions of this section, the directors under whose administration the same may have happened (except those who may have caused their dissent therefrom to be entered at large on the minutes of the directors at the time, or were not present when the same did happen) are, in their individual or private capacity, jointly and severally liable to the corporation, and to the creditors thereof, to the full amount of the capital stock so divided, withdrawn, paid out, or reduced or debt contracted."

Section 309 remained in the above form until 1929 when a radical change in its provisions was affected by Stats. and Amdts. 1929, p. 1266, by which the section was amended to read as follows (omitting immaterial portions):

> "Unless they shall have been first permitted or authorized so to do by the commissioner of corporations, directors of corporations must not make dividends except from the surplus profits arising from the business thereof; nor must they divide, withdraw, or pay to the stockholders, or any of them, any part of the capital stock, except as hereinafter provided; provided that dividends may be paid upon shares entitled to cumulative preferential dividends from paid-in surplus, as well as from profits arising from the business, but the holders of such shares shall be notified when dividends are paid from paid-in surplus. Nothing herein prohibits a division and distribution of the capital stock of any corporation which remains after the payment of all its debts, upon its dissolution or the expiration of its term of existence.
>
> In case of any wilful or negligent violation of the provisions of this section, the directors under whose administration the same shall have happened, except those who cause their dissent therefrom to be entered on the minutes of such directors at the time, or were not present at that time, shall be jointly and severally liable to the shareholders of such corporation to the full amount of any loss sustained by such shareholders, or in case of the insolvency of the corporation to the corporation or its receiver, liquidator or trustee in bankruptcy to the full amount in either case of any loss sustained by the shareholders or creditors by reason of such unauthorized dividend, withdrawal or distribution."

In the general revision of the corporation law of California in 1931 the material covered by section 309 was amended and re-numbered 363 by Stats. 1931, p. 1850, which section as amended went into effect on August 14, 1931. This new section (omitting immaterial portions) reads as follows:

> "Except as provided in this title, the directors of a corporation shall not authorize or ratify the purchase by it of its shares with corporate funds nor declare or pay dividends nor authorize or ratify the withdrawal or distribution of any part of its assets among its shareholders.
>
> In case of any wilful or negligent violation of the provisions of this section, the directors under whose administration the same shall have happened, except those who may have caused their dissent therefrom to be entered on the minutes of the meeting at which such action was authorized, or who were not present at the time, shall be jointly and severally liable to the corporation and to shareholders and subscribers for the full amount of any loss sustained by the corporation, the shareholders and/or subscribers.
>
> In case of the insolvency of the corporation the directors shall be jointly and severally liable to the corporation or its receiver, liquidator or trustee in bankruptcy to the full amount of any loss sustained by the shareholders or creditors by reason of such unauthorized dividend, withdrawal or distribution.
>
> A director shall not be held to have been negligent within the meaning of this section if he relied and acted in good faith upon a balance sheet or profit and loss statement of the corporation represented to him to be correct by the president or the officer of the corporation having charge of or supervision of its ac-

counts, or certified to be correct and according to the books of the corporation by a public accountant or firm of public accountants selected with reasonable care."

The latest amendment to section 363 was passed in 1933 (Stats. and Amdts. 1933, p. 1396) and the section as thus amended went into effect on August 21, 1933, and has not been further modified since that time. The present section (omitting immaterial portions) reads as follows:

"Except as provided in this title, the directors of a corporation shall not authorize or ratify the purchase by it of its shares or declare or pay dividends or authorize or ratify the withdrawal or distribution of any part of its assets among its shareholders.

In case of any wilful or negligent violation of the provisions of this section the directors under whose administration the same shall have happened, except those who may have caused their dissent therefrom to be entered on the minutes of the meeting at which such action was authorized, or who were not present at the time the board acted, shall be jointly and severally liable to the corporation or to its receiver, liquidator or trustee in bankruptcy for the benefit of the creditors of the corporation or any of them and of the shareholders and owners of shares at the time of such violation, for its debts and liabilities existing at the time of such violation, and for the full amount of any loss sustained by such holders and owners of shares other than shares upon which any such payment or distribution was made, in any such case not exceeding the amount of such unlawful dividends, purchase price, withdrawal or other distribution.

Any judgment creditor of the corporation, or two or more such creditors, if the debt or claim arose prior

to the time of such violation, may sue the corporation and any or all of its directors in one action and recover judgment for the amount due such creditors or claimants from the corporation against any or all of such directors guilty of any such violation up to the amount of such unlawful dividends, purchase price, withdrawal or other distribution. An action against such directors for any such violation may be brought by the corporation or by its receiver, liquidator or trustee in bankruptcy for the benefit of all of such creditors, owners of shares and shareholders without the necessity of any prior judgment against the corporation, for the recovery of the amount of such dividends, purchase price, withdrawal or other distribution as far as needed to satisfy such debts and liabilities and the full amount of loss sustained by such shareholders.

A director shall not be held to have been negligent within the meaning of this section if he relied and acted in good faith upon a balance sheet or profit and loss statement of the corporation furnished or exhibited to him by the president or the officer of the corporation having charge of or supervision of its accounts, or certified to be correct and according to the books of the corporation by a public accountant or firm of public accountants selected with reasonable care."

The trend in statutory provision is clear from these sections. Section 309 established an absolute liability. Certain acts were prohibited and in the event of the occurrence of any prohibited act liability was automatically imposed upon the designated persons. Whether or not anyone, creditor or stockholder, had been injured was immaterial.

Talcott Land Company v. Hershiser, 184 Cal. 748, 195 Pac. 653 (1921). Good faith on the part of a director was of no significance. *Southern California Home Builders v. Young,* 45 Cal. App. 679, 188 Pac. 586 (1920).

The period of existence of section 309 in its more severe form corresponds roughly with the period during which stockholders in California were subject to liability for corporate debts under section 3 of Article XII of the California Constitution of 1879, and former section 322 of the Civil Code. California corporations were made true limited liability companies by the elimination of this constitutional provision in 1930. Thereafter, in 1931, followed a general revision of the corporation laws, bringing them more in harmony with modern provisions and practice in other states.

The change with reference to the liability of directors is explained by Professor Henry Winthrop Ballantine, who served as draftsman of the Committee of the State Bar on Revision of the California Laws for the 1929 and 1931 sessions of the legislature, in his treatise on California Corporation Laws (1932), as follows:

> "Under the former law the liability of directors for unauthorized dividends did not depend upon their wilfulness or negligence and the fact that no one was injured by an unauthorized dividend did not excuse the directors. The corporation could sue without reference to any damage to creditors or shareholders. This rule was changed by the amendment of 1929. Under section 309 as amended, as under the present law, the right to recover against directors depends upon culpability and whether creditors or shareholders have been injured."

In considering the substantiality of the evidence to support the decree on the basis of section 363 the first point to be noticed is that Klipstein was at no time a *de jure* director or officer of the drug company. No permit to issue its shares was ever issued to the company by the Corporation Commissioner of the State of California. [Tr. pp. 57, 64.] Under the California Corporate Securities Act prior to 1931 shares issued without a permit or contrary to the terms of any permit were absolutely void. See:

> *Ballantine, opus cit.*, p. 606;
>
> *General Laws of California* (Deering, 1923), Act 3814, section 12;
>
> *Klinker v. Guarantee Title Co.*, 98 Cal. App. 469, 277 Pac. 177 (1929);
>
> *Castle v. Acme Ice Cream Company*, 101 Cal. App. 94, 281 Pac. 396 (1929).

The shares placed in Klipstein's name as security did not therefore make him a *de jure* stockholder. He would not have been liable to the creditors of the corporation on any stockholder's liability. *Regan v. Albin*, 219 Cal. 357, 26 Pac. (2d) 475 (1933). At this time only stockholders could be *de jure* directors. See former section 305 of the Civil Code (Stats. and Amdts. 1905, p. 503); *Rozecrans Gold Mining Co. v. Morey*, 111 Cal. 114, 43 Pac. 585 (1896). A subsequent change in the law did not operate to make him such. *Rozecrans Gold Mining Co. v. Morey, supra.* In addition he would not be a *de jure* director in any event after the ending of the term for which he was elected. *Kinard v. Ward*, 21 Cal. App. 92, 130 Pac. 1194 (1913).

Any liability on Klipstein's part must therefore be predicated on the theory that he was a *de facto* director and officer. Before considering the substantiality of the evidence in this connection it is appropriate to discuss briefly the principles underlying the idea of *de facto* directors and officers.

The law relative to *de facto* officers arises from the same considerations which govern the law in its dealing with apparent agents in the field of contracts, or of promissory estoppel in the field of offer and acceptance, or of equitable estoppel in the general field of the law. The underlying idea is that a person who assumes to act where he has no right will be held responsible as if he had that right and that other persons who allow him to assume any such position will not be heard to say that the assumption was not rightful. In the case of officers and directors of corporations the most common instance of the use of the principles of *de facto* directorship is where the corporation is trying to evade an obligation entered into on its behalf by persons who may not have been authorized so to act with all due formalities. It would of course be grossly inequitable to allow such an avoidance of an obligation, especially if the stockholders have acquiesced in the actions of the purported directors, and the law is settled that in such a case the corporation will be bound. See 6 *Cal. Jur.*, p. 1046, section 423, and cases therein cited.

This is in reality no more than the law of apparent or ostensible agency. See *American Concrete Units Co., Inc., v. National Stone Tile Corp.*, 115 Cal. App. 501, 1 Pac. (2d) 1084 (1931); Morawetz, Private Corporations (2d Ed.), Vol. 2, section 640. Likewise, a person assuming to act as a director is held to the same duties

to shareholders as a legally elected director and cannot evade his obligations by pointing to an imperfection in his title to office. *People v. Leonard,* 106 Cal. 302, 39 Pac. 617 (1895). This is simply a part of the law of estoppel.

The character of the acts which a person must perform in order to be tagged with the designation "*de facto* director" varies with the type of relief sought. This is not explicit in the decided cases but can be seen clearly below the surface. *Eel River Navigation Co. v. Struver,* 41 Cal. 616 (1871); *First African M. E. Zion Church v. Hillery,* 51 Cal. 155 (1875); *People v. Leonard,* 106 Cal. 302, 39 Pac. 617 (1895); *Rosecrans Gold Mining Company v. Morey,* 111 Cal. 114, 43 Pac. 585 (1896); *Barrell v. Lake View Land Co.,* 122 Cal. 129, 54 Pac. 594 (1898); *Sherwood v. Wallin,* 154 Cal. 735, 99 Pac. 101 (1908); *Chandler v. Hart,* 161 Cal. 405, 119 Pac. 516 (1911); *Kinard v. Ward,* 21 Cal. App. 92, 130 Pac. 1194 (1913). Inasmuch as the California decisions are not numerous and contain few discussions of the basis of *de facto* directors' liability the underlying considerations upon which the doctrine is founded must be kept in mind in order to understand the results in particular cases. The definition from Fletcher, Cyclopedia of Corporations (Perm. Ed. 1931), Vol. 2, p. 145, already quoted *supra,* by its very wording illustrates these considerations:

> "One in actual possession of an office under claim and color of election or appointment, and *continually exercising its functions and discharging its duties,* is an officer *de facto.*"

The point most stressed is the "assumption" of corporate office. Turning to the record on this appeal it is evident that there is absolutely no proof of any sort that

Klipstein "assumed" to act for the corporation in any capacity *during the entire period of the withdrawals.* The meetings in December, 1927, and January, 1928, were obviously perfunctory. All such meetings were *prior* to any withdrawals of corporate funds. [Tr. pp. 39-42.] From the time of the last of these meetings until the meeting of October 19, 1935, the drug company was run entirely by Stelzner. Klipstein was in the title business and had no interest in the drug store. There is no evidence that he ever took part in the management of the store in any capacity or that he knew anything at all about its affairs. This was the period when Stelzner withdrew over his own signature all of the funds which were paid to the bank. It was only *subsequent* to all such withdrawals and in an attempt to salvage something for the benefit of all parties that Klipstein again assumed to act as director of the company in forcing Stelzner to execute with him a corporate note for the balance of the debt owed to the bank. [Tr. pp. 60-61.] As shown above, the corporation in so far as creditors are concerned was uninjured by the giving of the note, which it never paid, or by the suit and execution sale which followed. The corporation and its creditors received all the benefits of these actions.

Under these circumstances how can it be said that Klipstein ever assumed to act for the corporation at the times when the various withdrawals of funds were made? There is absolutely no evidence of any action on his part of any nature as a corporate officer during this time. To say that the purported election in 1928 placed upon Klipstein the duty to remain in contact with the affairs of the drug store would be to ignore the fact that Stelzner was

the sole person interested in the business and would make the mechanics of the transaction by which Klipstein aided his brother-in-law a veritable trap in which he would be caught and made to answer for acts with which he had no connection whatsoever. The original incorporators, who were the only *de jure* directors of the company, were as much connected with the corporate affairs as Klipstein, which is to say not at all. To Klipstein Stelzner and the drug store were identical. Klipstein had no interest in the business, knew nothing about it, and paid no attention to it. The transactions involving the withdrawal of funds were entirely between Stelzner and the bank. As long as Stelzner made payments from any source which kept the bank satisfied Klipstein had no cause to investigate or question anything. There is of course no evidence that the drug store was Stelzner's only asset and no showing that Klipstein had any reason to believe that such payments were not being made from Stelzner's personal funds.

It is just and reasonable that anyone assuming to act for a corporation should be held to a strict standard of accountability. It would be most unjust and unreasonable, on the other hand, to ignore the realities of a one-man corporation and to say that any connection, however nominal, would entail a liability in a case where the person sought to be held liable never at any time received any benefit at all and took no active part in any of the transactions.

A further reason why Klipstein cannot be held liable under the provisions of section 363 is that this section specifically excepts from liability any director who was not present at the time when a prohibited withdrawal was authorized by the Board. In this case it is undisputed

that Klipstein never attended any Board meetings during any part of the period over which the withdrawals were made. As a matter of fact Stelzner completely filled the position ordinarily occupied by a board of directors and his affairs and those of the company were so far identical that Klipstein had ample reason, under California law, to consider one the *alter ego* of the other in relation to all the transactions in question. See *Sargent v. Palace Cafe Co.*, 175 Cal. 737, 167 Pac. 146 (1917); *Scales v. Holje*, 41 Cal. App. 733, 183 Pac. 308 (1919). Under these circumstances Klipstein is completely within the exception mentioned and no liability on his part can be predicated upon the provisions of this section.

Even assuming that Klipstein were otherwise liable under section 363 a reading of that section will disclose that the liability created therby is so limited that the evidence in this case could not support a decree for the amount found due by the trial court. By its provisions liability is imposed upon directors only *"for the debts and liabilities existing at the time of such violation."* Paragraph 3 of the section provides that any judgment creditor may sue a director *"if the debt or claim arose prior to the time of such violation"* and further provides that when the action is brought by a trustee in bankruptcy it is considered to be for the benefit of all *such* creditors and recovery is limited to the amount needed to satisfy *such* debts and liabilities.

The extent of the liability created by this section is clear. It is limited to the amount due to any creditor, whether suing on his own behalf or through a trustee in bankruptcy, and *part of the creditor's cause of action is to show that the debt still unpaid arose prior to the time of*

the asserted violation. Appellant has already discussed the failure of proof on this score above in this brief. All that Sears attempted to show at the trial was that at the time of any one particular withdrawal there existed one certain creditor whose claim at the moment upon an open book account exceeded the amount of the withdrawal. For all the proof shows this one creditor might have been paid in full on the next day following each withdrawal. There is no showing that the same obligation remained throughout the entire period and as a matter of fact it is obvious that Stelzner was constantly purchasing from this creditor so that the current balance would have no significance whatsoever. Sears has proved nothing to take McKesson and Langley out of the class of "subsequent creditors" who, by the very words of the statute, cannot complain.

The decision of the trial court in this case was rested by it solely upon the authority of one case, *In re Wright Motor Company*, 299 Fed. 106 (C. C. A. 9, 1924), in which this Court affirmed the decision of the District Court for the Northern District of California in *Oliver v. Brennan*, 292 Fed. 197 (1923). See Minute Order of December 4, 1937 [Tr. p. 24].

The decision in the *Wright Motor Company* case rests upon facts entirely different from those in the case at bar and was based upon provisions of law not in effect when the events in this case took place.

In that case Oliver, trustee in bankruptcy of Wright Motor Company, Ltd., brought suit in equity against one Brennan to set aside certain transfers of money and personal property made by the bankrupt. The evidence showed that the bankrupt was incorporated on February 26, 1920, for the purpose of dealing in automobiles, and

that the incorporators were one West, one Wright, and the defendant Brennan, who was an attorney at law. The capital stock was $37,500, divided into 375 shares of the par value of $100. In March, 1920, 125 shares were issued to Brennan and 125 shares to Wright, for which each paid $12,500 cash, and 125 shares to West for certain physical assets. These three parties continued as sole stockholders, directors and officers until July 14, 1920.

On April 24, 1920, by written contract, Wright agreed to buy Brennan's 125 shares and West's 125 shares (for which Brennan had originally put up the money) and to pay Brennan $25,000 in designated installments. At the time when this contract was executed Wright had no personal funds, a fact which was known to Brennan. Performance of the contract was undertaken and on the day of its execution an initial payment of $10,000 was made. This money was paid directly by the corporation to Brennan by a corporate check signed by Brennan. The corporation received a note from Wright for $10,000, which note seems to have subsequently disappeared. Thereafter and up to August 31, 1920, other corporate checks were delivered to Brennan, for which the corporation received no notes or other consideration. By that day Brennan had received a total of $18,472.92 and in addition substantial personal property from the corporation. By November 13, 1920, all but $500 of the purchase price of the stock had been paid to Brennan, either in cash or in property. On February 26, 1921, exactly a year after its incorporation, the corporation assigned for the benefit of creditors and on May 4, 1921, was adjudicated a bankrupt. On this day it had assets of $868.40 against claims amounting to $9,436.95. The evidence further showed that Bren-

nan, an attorney, was at all times acquainted with the condition of the business and had deliberately attempted to dispose of his shares and recover back his investment in order to avoid liability to creditors of the company.

The difference in the factual situation in the *Wright Motor Company* case and in the case at bar is apparent. There Brennan was a *de jure* director and officer and actively participated in the automobile business. Here Klipstein was never a *de jure* director or officer and never took any part in the management of the drug business. Brennan was the beneficial owner of a large proportion of the legally issued stock and himself participated in the very transaction by which actual cash and personal property, in fact almost the entire assets of the corporation, were transferred directly to him. Klipstein never beneficially owned any stock and even the pledged stock was void, unknown to him. Klipstein took no part at all in any transaction involving any withdrawal of funds from the corporation and never received one cent in cash or any other property of any kind belonging to the drug company. Brennan knew intimately the financial condition of the auto company, knew that under California law stockholders were proportionately liable for its debts and deliberately attempted to rid himself of his stock and escape with his investment. Klipstein knew nothing of the drug company's affairs, knew nothing about creditors until a few months prior to October, 1935, and his actions thereafter were taken in order to preserve rather than dissipate the assets of the corporation. Wright Motor Company, Inc., made an assignment for the benefit of creditors one year to the day after its incorporation and was adjudicated a bankrupt within three months thereafter. Klip-

stein, according to the undisputed evidence, had not the slightest connection with the drug company for a period of over *seven and one-half years* prior to the time when he first heard that there were any unpaid creditors. Such contrasts between the two sets of facts could be continued almost throughout every step of the two cases. In fact it is obvious that the positions of Brennan in the *Wright Motor Company* case and of Klipstein in the case at bar are as different as day and night.

The *Wright Motor Company* case could not have been decided otherwise than it was. In 1920, when the events in that case took place, every stockholder of the corporation was liable for his proportionate part of its debts (California Constitution of 1879, Article XII, section 3; Civil Code, section 322; Kerr's Cyc. Codes, 2d Ed., 1920). This was the liability that Brennan attempted to evade. In 1920, under section 309 of the Civil Code, directors were liable for impairment of the capital stock regardless of good faith or injury to any person. *Southern California Home Builders v. Young,* 45 Cal. App. 679, 188 Pac. 586 (1920); *Talcott Land Company v. Hershiser,* 184 Cal. 748, 195 Pac. 653 (1921). When the events in the case at bar took place these provisions had all been abolished. Klipstein would not have been personally liable for any part of the corporation's debts even had he been the beneficial owner of legally issued stock. The absolute liability provided for in former section 309 of the Civil Code had been eliminated and replaced by section 363 establishing liability of directors only on a basis of bad faith or negligence plus actual injury to stockholders or creditors. At the time of the decision in the *Wright Motor* case the Federal Court was free, under the doctrine of

Swift v. Tyson, 41 U. S. 1, 10 L. Ed. 865 (1842), to consider the decisions of other states or the general law in deciding the case. This is no longer proper since the decision in *Erie Railroad v. Tompkins,* 304 U. S. 64, 58 S. Ct. 817 (1938). Both as to the law and as to the facts the *Wright Motor Company* case is no authority whatever for the imposition of liability upon Klipstein in the case at bar.

A corporation is only a form of business organization and the fictions built up around the idea of corporate entity have never blinded the courts to the realities lying beneath these fictions. While there were three persons actively interested in the Globe Drug Company the corporate device served a useful and practical purpose. Corporate stock distribution determined the property interests of the parties and corporate practice provided a method for the settlement of business policies. After Stelzner bought out the interests of his co-owners the corporate form was entirely disregarded. To all intents and purposes the business was a sole proprietorship with Klipstein holding what might be called an equitable lien on a portion of the assets for moneys advanced to the proprietor. Stelzner alone ran the drug business, determined its policies and knew the condition of its financial affairs.

To hold that the retention of the shell of corporate organization, never legally completed by the issue of valid stock, should give Stelzner the power to impose upon Klipstein personal liability through transactions in which

Klipstein took no part, of which he had no knowledge and from which he derived no benefit, would be to throw a commercial loss upon a party not in the least responsible for its creation. The very creditor whose representative testified at the trial knew more about Stelzner's business than did Klipstein. It saw fit to deal with Stelzner over a period of more than seven years in which it allowed him open credit to the extent of several thousand dollars. It in no way relied upon Klipstein's connection with the enterprise. Now, through the trustee, it desires to recoup its loss from a person whom it probably never knew existed and who took no part in its relations with Stelzner. No such result is legally sustainable or intrinsically just.

The decree is not supported by the findings in that there is no finding that any creditors have proved their claims in the bankruptcy proceedings and remain unpaid.

Assignment of Error No. XXV [Tr. p. 88].

"The Court erred in making and entering its decree, as amended, for the reason that the facts found do not sustain said decree."

In his amended bill Sears alleged as follows:

"The above mentioned creditors of said corporation have duly proved their claims in said bankruptcy proceedings; there are not sufficient assets in the bankrupt's estate with which to pay such claims in full, and unless said payments made by said corporation,

> and said property, or its value, are restored to the bankrupt's estate, the claims of said creditors will remain unsatisfied." [Paragraph VIII, Tr. p. 8.]

These allegations were specifically denied by Klipstein in his answer. [Paragraph VIII, Tr. p. 12.]

No proof was introduced that any creditor's claim had been proved or approved in the bankruptcy proceedings or that any creditor remained unpaid at the time of the commencement of this suit, and the trial court made no attempt to find on these issues. *This failure to make a finding is fatal to Scars' case on appeal.* Equity rule No. 70½ provides that the trial court must find specially upon the issues raised. The sufficiency of the findings to support the decree in this case is before this court and obviously, no matter what Stelzner or Klipstein might have done in any event, there is no legal damage shown and therefore no liability unless creditors prove some injury existing at the time of the commencement of the suit.

Appellant has already shown that under both the "constructive fraud" theory and under section 363 of the Civil Code part of the creditor's case is the proof of a claim (1) in existence at the time of the transaction attacked, and (2) unpaid at the commencement of the action, and no further citation of authorities is necessary on this point. The absence of a finding that there was any such creditor so injured and that there were insufficient assets within which to pay approved claims makes the affirmance by this court of any decree in any amount impossible.

The decree entered is void in that the extent of Klipstein's liability is made thereby to depend upon a report made by a referee in a proceeding in which Klipstein is not represented and has no standing to dispute the propriety of any items in such report.

Assignment of Error No. XXVII [Tr. p. 88].

> "The Court erred in making and entering its decree, as amended, for the reason that said decree is void in that the liability of defendant to plaintiff is made by said decree to depend upon a report to be filed by one C. E. Arnold, Referee in Bankruptcy in the matter of the estate of the Globe Drug Company, Inc., bankrupt, in which proceeding in bankruptcy defendant is not represented and has no standing and defendant is therefore by said decree deprived of his day in court to litigate the reasonableness and propriety of any allowance and expenses included in said report to be filed by said Referee."

The trial court in its decree [Tr. p. 32] provided that Klipstein's liability should be determined by a report to be filed in the action by the referee in bankruptcy appointed in the bankruptcy proceedings of the corporation, and further directed that Sears have execution against Klipstein for the amount shown in such report.

In making and entering any such decree the trial court obviously exceeded its jurisdiction. Federal District Courts have the power to appoint referees in appropriate cases but the opportunity of each party to be heard in the proceedings before such referee is indispensable (see former Equity Rule 60; Federal Rules of Civil Procedure, Rule 53), and no report rendered by any such referee is

of any effect until approved by the court. *North Carolina R. R. Co. v. Swasey*, 90 U. S. 405, 23 L. Ed. 136 (1875). Klipstein is not represented, personally or otherwise, in the bankruptcy proceedings and would have no standing to contest the propriety of any claims or any expense allowances. As was said in *Postal Telegraph-Cable Co. v. Newport*, 247 U. S. 464, 38 S. Ct. 566 (1918): "The opportunity to be heard is an essential requisite of due process of law in judicial proceedings." The fact that the decree summarily deprives Klipstein of his day in court to litigate the extent of his liability renders the decree void on its face irrespective of all other considerations.

Conclusion.

Ths legislature of California has enacted as an important and integral part of the new California law section 363 of the Civil Code.

The opinion on this appeal will constitute the first interpretation of any court as to the meaning, validity and effect of certain amendments to that section.

Incidental to such interpretation this Honorable Court will also determine whether and how such amendments apply to this case.

It is presumed that the legislature knew the prior state of the law, as it stood at the time of the decision in the case of *In re Wright Motor Co., supra, and sought by the amendments to make some change therein.* Other things being equal, it will also be presumed that the legislature used the words of such amendments in their *plain, ordinary meaning.*

The legislative intent being plain, there is no need or room for consideration of policy, and it becomes the duty of the courts to give to such legislative enactments the meaning intended by the legislature.

A rule of a branch of the substantive law of the State of California, has expressly placed upon the appellee the duty of establishing the several elements of the case necessary to support a decree. Appellee must have recognized this necessity or he would not have attempted to plead these elements in his bill of complaint.

No evidence being given "his case fails."

As we have pointed out there is no evidence of (a) fraudulent intent on the part of Klipstein, or actual fraud of any kind on his part, (b) insolvency of the drug company at any time prior to its adjudication in bankruptcy, (c) that the claims of creditors, or any creditor, was equal to the amount of the decree, or, (d) that any creditor remained unpaid or does now remain unpaid.

Without again enumerating them, it clearly appears that appellee has also failed to give any evidence, or sustain the burden of proof, or comply with the Civil Code provisions, on other equally important propositions of law, each essential to a valid decree.

Appellant, therefore, respectfully requests that the decree as entered by the trial court herein be reversed.

Respectfully submitted,

Homer Johnstone,
Sidney H. Wyse,
Attorneys for Appellant.

No. 8994

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

. E. KLIPSTEIN, *Appellant,* vs. ERBERT P. SEARS, Trustee in Bankruptcy of the Estate of Globe Drug Company, Inc., *Appellee.*	}

BRIEF FOR APPELLEE.

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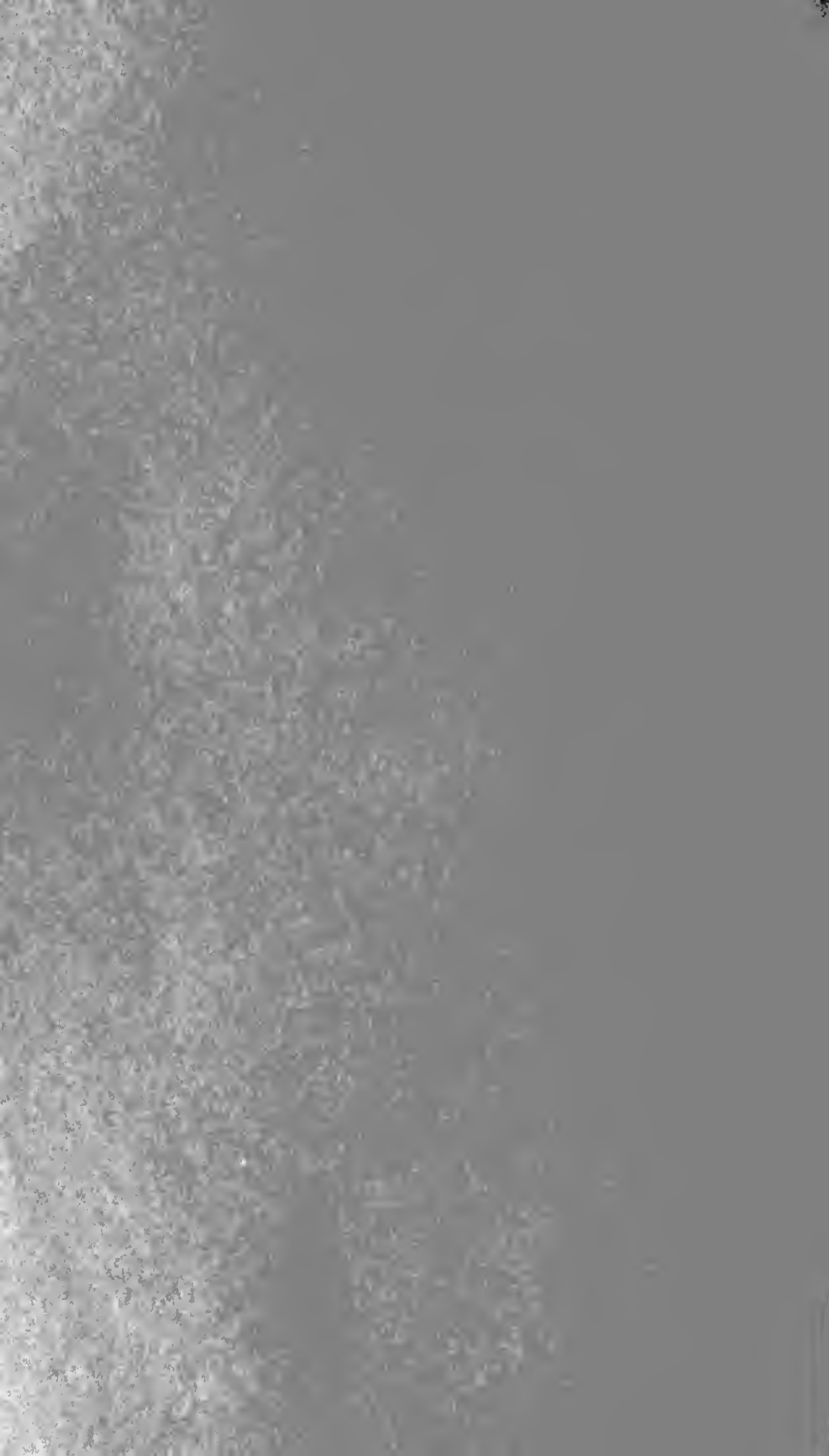

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No. 8994

IN THE

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BRIEF FOR APPELLEE.

STATEMENT OF THE CASE.

Appellee takes the liberty of setting forth his own s atement of the case, and the facts involved, for the ı ason that certain statements made by appellant in l s opening brief, or at least the conclusions based on t em, appear to us to be inaccurate.

The complainant, as trustee of the estate of the l nnkrupt corporation, Globe Drug Company, Inc., s eks to recover from the defendants certain money v rongfully paid out by the bankrupt corporation to c for the personal benefit of the defendants while t ey were directors, officers, and stockholders of said

corporation. The following is a brief resume of t facts upon which the claim is based.

Globe Drug Company, Inc., was incorporated und the laws of California in 1920, with an authoriz capital stock of 25,000 shares of the par value $1.00 each, and with a Board of Directors consisti of three members. (Tr. pp. 52, 53.) On Decemb 31, 1927 the defendants were elected as directors at stockholders' meeting duly called and held. On t same day, the directors met and elected officers, t appellant Klipstein then being chosen as vice-pre dent.

On January 3, 1928 the defendants Stelzner a Klipstein executed to the Bank of America their pe sonal promissory note in the sum of $17,000.00. Th signed this note as joint makers. Stelzner, the pre dent of the corporation, used the proceeds of this lo to purchase stock of the corporation from certain oth stockholders. Almost contemporaneously with t completion of such purchase, on January 5, 19 9990 shares of such stock were issued to the appella Klipstein. (Tr. p. 55.)

From the date of the maturity of said note, April 1928, periodical payments were made on account the principal and interest thereof during a period over seven years. (Tr. pp. 39-42.) All these paymer were made out of the corporation's own funds. (T p. 55.) They were made by corporate checks payal direct to the order of the bank, signed by Stelzner president. No consideration was ever received by for the corporation for such payments. (Tr. p. 56.)

Neither of the defendants has ever reimbursed the
rporation for any of these payments. There is no
owing that these payments were made out of surplus
ofits of the corporation, or that, at the time they
re made, the corporation ever had any surplus
ofits. There are no records in the Minute Book
en authorizing the payments.

On each and all of the dates when these payments
re made, the corporation was indebted in an amount
ceeding the amount of each payment. (Tr. pp.
-51.)

There is an incidental element in the facts which,
hile having nothing to do with the extent of the re-
very sought and awarded by the trial court, has an
direct bearing upon the position of the appellant
re. On October 19, 1935, when the $17,000.00 note
d been paid down to a balance of $4800.00, the cor-
ration, at the instance and direction of its Board of
irectors, and at a meeting at which the defendants
ere present and acting as such, executed its own
omissory note directly to the bank for said sum of
800.00 in payment of the balance then due on the
7,000.00 note. (Tr. pp. 55, 56.) The corporation
ceived absolutely no consideration for the execution
this note. (Tr. p. 56.) Contemporaneously with its
ecution and delivery, Klipstein purchased the note
om the bank, and immediately, on the same day,
mmenced an action in the Superior Court of Kern
unty, against the corporation, Globe Drug Com-
ny, Inc., for the recovery of $5364.00 claimed by
lipstein in his verified complaint to be due to him

from the defendant corporation. (Tr. p. 56.) $4800.0
of this claim was represented by the $4800.00 no
The same attorneys who represented Klipstein in th
action were at the same time also attorneys for t
defendant corporation. (Tr. p. 62.) A default jud-
ment was suffered to be entered against the corpor-
tion in favor of Klipstein, for the sum of $5373.8,
together with $177.00 costs. Pursuant to this jud-
ment all of the remaining property and assets of t
corporation were sold by the sheriff on execution sa
for the sum of $1935.00. (Tr. p. 58.) From th,
Klipstein, the judgment creditor, has withheld t
sum of $608.75. Subsequent to the filing of the i-
voluntary petition in bankruptcy as hereinafter r-
lated, said judgment creditor turned over the balan
to the trustee in bankruptcy.

On the petition of other creditors involuntary pr-
ceedings in bankruptcy were filed against the corpor-
tion on February 14, 1936, and it was adjudicated
bankrupt on March 6, 1936. On behalf of the ban-
rupt, Stelzner, its president, filed a schedule in ban-
ruptcy, showing debts of $11,043.87 and assets
$3985.63. Thus it appears that there is not enoug
money or property in the bankrupt's estate with whi
to pay its creditors and the expenses of administratio.

The question at issue in the case is whether the
two defendants, directors, officers, and shareholders
the bankrupt corporation, are liable to the trustee
bankruptcy for the funds of the corporation thus m-
appropriated by them, to an extent sufficient to satis
all just and proper claims and reasonable allowanc

ad expenses in the bankruptcy proceeding. The court bow has determined by its decree that they are so lible, and has limited that liability to the maximum etent of $4500.00, calculated by the court to be suf-fiient to pay all such claims, allowances, and expenses. The defendant Stelzner has prosecuted no appeal, and a to him the decree is final. His co-defendant, Klip-sein, the appellant here, has appealed, claiming the dcree is erroneous.

APPELLEE'S THEORY OF THE CASE.

This is a plenary suit in which the trustee of the bnkrupt seeks to recover for the estate property now blonging to it and necessary to pay the claims of ceditors.

There are various sections in the former Bank-rptcy Act conferring upon the trustee the right to rcover such property. These are Sections 47, 67, and 7. For the purposes of this discussion we can dis-igard Section 67, which has to do with the special and pculiar right of the trustee to avoid preferences. In te instant case it is not necessary for the trustee to asert a preference or to rely upon Section 67, and he ces not do so.

Since the amendment of 1910 to the Bankruptcy Act, the trustee's title to such property is three-fold, nmely, he takes, first, the title of the bankrupt; scond, the title of creditors; and third, the peculiar ight to set aside preferences. The second title, that

which he derives from creditors, is itself three-fold: First, the right to recover property fraudulently held; second, the right to avoid transactions which are void as to existing creditors; and third, the right of a creditor under state law, armed with process, whether or not, in fact, there be such creditor actually in existence. (Remington, Vol. 4, Sec. 1508.) Here the trustee has all of these rights, except the right to avoid a preference, which, as stated above, he does not assert.

As appears from the allegations in the bill (Tr. pp. 5-10), the defendants have a dual responsibility to the trustee. In the first place, they occupy the position of recipients of the benefits of the wrongful transfers by the bankrupt corporation of its property. In the second place, they are not only the recipients of these benefits, but are also the agents and representatives of the corporation through whom it acted in disposing of the property. And inasmuch as the bankrupt is a corporation and the defendants were its directors, officers, and stockholders, there come into play all those legal rules and principles under which such corporate agents and representatives are held liable, not only under statutory law, but the common law as well, for wrongfully disposing of, misappropriating, and wasting the corporation's property to their own benefit.

There is one general fallacy in the position taken by the appellant Klipstein in the arguments advanced in his opening brief. He would seek to have his liability measured exclusively by a particular statute, which is

esigned to impose a liability upon corporate directors
or specific wrongs done during their administration
n office. Appellant forgets or disregards the common
aw, and all the other general legal principles recog-
ized not only in California but in all the states, which
ave always imposed upon corporate directors and
fficers liability for malfeasance or misfeasance in
ffice, or for participating in or benefiting from a
isappropriation of the corporation's assets. Indeed,
proper regard for this aspect of the law pertinent
this case reveals a complete answer to almost the
ntire brief of the appellant. We will attempt to make
his clear in our argument hereinafter set forth.

ARGUMENT.

LIPSTEIN WAS A DIRECTOR, OFFICER, AND STOCKHOLDER OF THE CORPORATION DURING ALL OF THE TRANSACTIONS INVOLVED.

Appellant seeks to escape his liability upon the spe-
ous contention that he was never a director, officer,
r stockholder of the corporation, and even that Globe
rug Company, Inc., was never organized as a cor-
oration.

In his original verified answer there was a clear
dmission of the allegation of the bill that the corpo-
ation was duly organized and existing under and by
irtue of the laws of the State of California. (Tr. p.
1.) The same admission appears in Stelzner's an-
wer. (Tr. p. 16.) Klipstein, at the trial, filed an
mendment to his answer in which, in the face of his

sworn admission in his original answer, he sought t
deny the organization of the corporation. (Tr. p. 21
Of course the evidence clearly shows the due organiz
tion of the corporation as such, with all the requisi
incidents, such as an authorized capital stock, a Boa
of Directors, and officers, all functioning as suc
(Tr. p. 53.)

The corporate records further show that on Decen
ber 31, 1927, at a meeting of directors at which h
was present and acting, Klipstein was elected as th
vice-president of the corporation, and that on Janua
4, 1928, at a directors' meeting at which he was prese
and acting, he was elected secretary of the corporatio
This corporate record was attested by Klipstein's ow
signature. (Tr. p. 53.)

A great deal of argument is indulged in by Kli
stein in which, in the face of these records, he seel
to disavow his capacity as a director, now directing
collateral attack against his qualification as such. W
believe such a discussion is wholly unnecessary an
futile, for various reasons. It must be remembere
that Klipstein was continuously a director from an
after December 31, 1927, when he was elected. The
is no evidence that he ever resigned or that any su
cessor to him was ever elected. He acted as a directo
at the meeting of October 19, 1935. (Tr. p. 53.) H
denies that he was a *de jure* director, because he wa
not a stockholder. The evidence shows that stock wa
issued to him on December 21, 1927, prior to his ele
tion, and again on January 5, 1928. He accepted an

receipted for this stock. (Tr. p. 55.) He never transferred it. He now claims that this stock was void because it was issued without the permit of the Corporation Commissioner; that, therefore, he lacked the legal qualification for a *de jure* director. Even if such a contention were important here, this appellant would not be permitted to seek refuge behind it to the prejudice of a third party. Moreover, the acts complained of here took place in and after the year 1933, at which time it was no longer necessary for directors of California corporations to be stockholders in order to qualify. (Section 305, Civil Code.) If there were any doubt of his *de jure* capacity, certainly there could be none that he was, and acted as, a director *de facto*. (6A Cal. Jur. p. 1068.)

Klipstein does not, and cannot, deny that he was an officer, the secretary, of the corporation, during the times involved. He was elected as such on January 4, 1928. We find him acting as such on October 1, 1935. We must assume that he continuously occupied such office during all such interval of time and thereafter, because there is no record or other proof of a successor to him ever being elected.

There is ample evidence in the record to sustain the court's finding that at all of the times involved Klipstein was a director, officer, and stockholder of the corporation.

KLIPSTEIN PERSONALLY BENEFITED FROM THE MISAPPR-
PRIATION OF THE CORPORATION'S ASSETS.

Klipstein says that he received no benefit from th
payments made by the corporation to the bank on h
and Stelzner's personal note. He makes such con
tentions as these: that he was but an accommodatio
maker; that he received no part of the consideratio
for the note; that the bank regarded him as only
surety on the note, etc. These are such contention
as he might be expected to make if he were bein
sued on the note.

But he is not here being sued on the note; he i
being sued for misappropriating and wasting the cor
poration's assets, and the fact that he personall
benefited from the disposition of those assets link
him closer to the wrong and accentuates his liability
It is conceded by Klipstein that he was liable on th
note. It is immaterial whether his liability was tha
of joint maker, guarantor, surety, or otherwise. H
recognized his liability, because when payments be
came delinquent the bank called upon him and he mad
them. (Tr. p. 61.) It is apparent that every tim
the corporation made a payment on the note, i
satisfied *pro tanto* Klipstein's liability on it. Conse
quently, he was in the position of a corporate di
rector and officer, using the corporation's funds t
satisfy his own personal obligation, and appropriating
and consenting to the appropriation of, the corporat
assets to his own use. Clearly it was a misappropria
tion, because the corporation never owed anything t
Klipstein and received no consideration for thus pay
ing out its funds. All this is to say nothing of th

icidental fact that the corporation's funds were used
idirectly to purchase outstanding stock, 9990 shares
f which went to Klipstein upon its purchase, which
i but an additional indication that Klipstein was a
eneficiary of the misappropriation of the corporate
ssets. He says in his brief that he was not beneficially
iterested in this stock; Stelzner admitted in his an-
wer that the stock was put in Klipstein's name as
ecurity. (Tr. p. 16.) But the stock records set forth
o such qualifying entries; they show Klipstein to
e the absolute owner thereof. (Tr. p. 55.) In either
ase he was benefited.

THE NATURE OF KLIPSTEIN'S LIABILITY.

In considering the nature of Klipstein's liability
ı this case, it is necessary at all times to bear in
ind the position which he occupies. Not only was
e a director and officer of the corporation, and as
ich an actor in the disposition of the corporate
ssets, but also he was the recipient of the benefits
esulting therefrom. Moreover, this complainant-
ustee in bankruptcy not only represents the cred-
ors of the bankrupt estate, with the incidental rights
onferred by the Bankruptcy Act, but he also repre-
ents the bankrupt corporation and stands in its
loes, a corporation which was under the complete
omination and control of the defendants. He has
icceeded to any and all rights that the bankrupt
ad against any and all parties for the recovery of
ny of the corporation's property that might have

been wrongfully dissipated, wasted, given away,
misappropriated. Also, we must not forget that th
appellant in the eyes of the law occupied a fiducia
relationship to the bankrupt corporation, in line wi
which he was at all times bound to exercise the hig
est degree of good faith and honesty in connectio
with its affairs.

We are reminded by counsel, unnecessarily,
course, that the liability of the appellant depends upo
the law of the State of California. They studious
draw attention to a recent decision of the Unite
States Supreme Court in *Erie Railroad Company*
Tompkins which, by overruling *Swift v. Tyson,* pr
duced a marked change in the conception of the la
governing federal courts. But however interestin
counsel's point may be in the abstract, there is n
necessity for a consideration or discussion of it her

The trustee quite readily concedes that the appe
lant's liability must be determined in accordance wit
legal principles recognized in the State of Californi
He denies, however, that these legal principles mu
be confined within the narrow limits contended for b
the appellant. We maintain that there is here no
only ample statutory enactments declaring appellant
liability, but also that in California certain rules an
principles outside the written law have long bee
enforced, under which the appellant must be hel
answerable for the wrongs complained of here.

DEFENDANTS' POSITION AS CORPORATE AGENTS.

Let us consider appellant's position as a director ad officer, in other words, an agent, of the corporaton. A director is charged with the highest degree f good faith. Under the circumstances involved in tis case, he is a trustee for the corporation and as ach occupies a fiduciary relationship. He must not nite his personal and representative character in the me transaction, nor must he use his official position benefit himself individually. (*Dean v. Shingle*,)8 Cal. at p. 658.)

These duties, and the obligations arising therefrom, hve always been imposed upon corporate directors ad officers, and they exist today, regardless of whether r not they are the subject of legislative enactment. n California these principles have always been fundaental in the corporation law of that state.

> "Directors are also trustees for the stockholders and indirectly for the creditors. They have always been held responsible as trustees in their management of the property and affairs of the corporation. Like trustees, they must not deal with the subject of the trust for their own advantage, * * *.
>
> "Directors and officers of corporations, as well as trustees, have always been held responsible for loss resulting from misappropriations of the trust property made by them or with their consent. The character of the misappropriations for which the officers who made them can be held responsible to the corporation has been settled in many cases. The liability has existed

ever since there have been courts of equity and corporations or trustees."

Winchester v. Howard, 136 Cal. at pp. 442, 443.

In California statutory enactments have never changed this liability. The legislature has, it is true, taken cognizance of situations in which a director may not be a direct actor in the wrong and, therefore individually culpable. Under these particular conditions they have sought to create directors' liability for certain specific acts, and in doing so they have prescribed certain conditions which must exist for the imposition of such liability. However, it is inconceivable that California, or any other state, could ever pass a law affecting the liability of a corporate director to make restitution to injured parties of moneys and assets of the corporation that he has withdrawn and appropriated to his individual use and benefit. As said in *Southern Cal. Home Builders v. Young,* 45 Cal. App. at pp. 690, 691:

> "It has always been presumed that directors have knowledge of the business of the corporations it is their duty to manage and control. Before the adoption of any of the statutes in terms making directors liable, among other things, for declaring dividends out of capital, it was recognized both in the courts of common law and in the courts of equity that directors as trustees were liable for acts of malfeasance or misfeasance by which the capital of the corporation might be improperly depleted. * * * In the growth of corporate intervention in ordinary business affairs,

> it is inconceivable that by the adoption of these statutes the legislatures of a number of states intended to lessen the responsibility of directors by declaring them liable for specific breaches of trust, which by their mention in the statute might have the effect of relieving the directors from civil liability for other breaches not mentioned."

The fallacy of appellant's position, emphasized throughout his brief, lies in his effort to persuade this court that the measure of his liability in this case lies entirely within the terms and provisions of Section 363 of the Civil Code of California, as amended in 1933. He studiously calls attention to the limitations prescribed in that statute and contends that the evidence in this case falls short of fulfilling the required conditions of the liability there declared. It is true that in his bill complainant set forth a second cause of action in which was contained a conclusionary allegation that the misappropriation and withdrawal of corporate funds by the defendants was in violation of Section 363, C. C., and its predecessor, Civil Code Section 309. However, consistent with the rule of pleading in equity cases, the bill contains a concise statement of the facts pertinent to the wrongs complained of and the liability sought to be imposed, and the existence of the liability is none the less affected whether it be by virtue of any particular statute, or in accordance with recognized legal principles aside from any statute.

Appellant in his brief devotes much of his argument to some of the conditions necessary for the imposition of the liability prescribed by Section 363, C. C. He complains, among other things, that there is no showing in the evidence that Klipstein assumed to act as a director, that he was present when the withdrawals were authorized, that he ever assented to such withdrawals, and of the exact amount of the debts which existed at the time of each of the numerous withdrawals over the period of more than seven years. If we were seeking to establish here only the particular liability declared by Civil Code Section 363, if this were not a case of downright misappropriation of the corporation's assets, if Klipstein knew nothing of the nature and purpose of the withdrawals, or if the payments to the bank in no way benefited him individually and personally, there might then be some reason for a careful consideration of the existence here of these particular statutory conditions. But it is plain to be seen that Klipstein does not occupy a position to which these conditions are necessarily pertinent. Of course it is apparent on the face of the situation that even the conditions prescribed by the code section do in fact exist. As we have demonstrated above, Klipstein was a director and acted as such; while no actual resolutions were adopted authorizing the payments to the bank, nevertheless Klipstein must have known that the payments were being made to the bank and credited upon his note obligation; obviously he consented to the making of the payments by accepting the benefit thereof; he actively participated in the passag

of the resolution of the Board of Directors authorizing the execution of the $4800.00 note in satisfaction of the balance due on his note to the bank; every time a withdrawal was made, the corporation was indebted in excess of such withdrawal. Therefore, even if it were necessary in this case for the trustee to rely solely upon the liability declared by the particular statute, his showing is amply sufficient to justify the imposition of it. It must not be forgotten that the defendants failed to make any showing at the trial justifying the withdrawals. Stelzner alleged in his answer that the withdrawals were made from surplus profits. (Tr. p. 17.) But no attempt to prove this was made, nor was any attempt made to show that such existing indebtedness had ever been paid.

Klipstein tries to make us believe that he was at all times so remote from the situation as to excuse him from the liability. He insists that his own case is to be differentiated from that of his cohort, Stelzner, who admits his liability. He now says that he had no interest in the corporation's drug business. But he concedes that he helped his brother-in-law, Stelzner, to borrow the money from the bank to purchase outstanding stock, some of which he received. He disavows his directorship, although he consented to his election, accepted the offices of director and secretary, and actively participated in regular corporate proceedings. He now denies he was a stockholder, although he took and received a substantial portion of the corporation's stock which he helped his brother-in-law to buy for $17,000.00, without at that time, or

until now, raising any question as to the regularity of such stock. He now says that he can never get it out of his head that there was no corporate entity and that the Globe Drug Company, Inc., consisted of an individual, his brother-in-law; all in the face of the fact that he was an experienced businessman engaged in the title business, lent himself to dealings in the corporation's stock, and participated in proceedings appropriate to the conduct of corporate business. In addition to all this we find him commencing an action against Globe Drug Company, Inc., a corporation, not against Stelzner, individually, for money which he swore was due to him from the defendant corporation, not from Stelzner individually. He now says that he has never derived any gain or benefit whatsoever from his relationship with the corporation, and that in fact he is the loser. But as a result of the loan which he helped his brother-in-law make, he acquired 9990 shares of the corporation's stock, practically a two-fifths' interest in the corporation's business.

It is interesting to reflect for a moment upon what the situation might have been if this corporation had prospered, had made money, and been able to pay all its debts as they matured. Then, of course, we would not be here before this court, and there would then be no necessity for Klipstein to urge these various fantastic contentions. But the corporation failed and is now defunct. It is in bankruptcy, with numerous unpaid creditors. Its stock is valueless, and perhaps in that sense Klipstein has suffered a loss. But the corporation is defunct and in bankruptcy because it used

its assets to buy up stock for Klipstein's and Stelzner's account. If that had not been done, there would have been no bankruptcy and no unpaid creditors. Courts are constantly faced with situations where men become connected with corporate business ventures, either actively or inactively, under which they and their associates at the time give little thought to the possible consequences in case the venture fails. They willingly assume the probability of gain, but they avoid the thought of the possibility of losses. When failure occurs they seek to disavow any connection with the enterprise and urge the courts to relieve them from responsibilities which they should have comprehended and appreciated in the beginning. There could be little safety in commercial transactions if the law permitted, through the use of the corporate fiction, such a violation of creditors' rights.

THE DEFENDANTS ARE CHARGEABLE WITH FRAUD.

It is contended by appellant's counsel that there is no showing of either actual or constructive fraud on the part of the defendants. In our opinion it is wholly unnecessary to indulge in an extended discussion of this point. In so far as it is necessary, the evidentiary facts are sufficient upon which to base the finding of the court that the flagrant misappropriation of the corporation funds, continuously over a long period of time, constituted fraud.

These defendants here are concededly guilty of taking the corporation's funds and appropriating them to

their own use. The law says that this is a fraud. The courts declare it to be constructively fraudulent as to the creditors of the corporation. (14a *C. J.*, pp. 180, 188.) Any violation of a duty growing out of a fiduciary relationship is constructively fraudulent.

Under all these circumstances it was incumbent upon the defendants to show to the court, if they could, the bona fides of their acts.

> "Moreover, whether or not these directors were trustees for creditors (see cases, 14a C. Jur. 169), their status was so far fiduciary in respect to creditors that they are subject to the rule that these corporate transfers challenged, the burden is defendant's to vindicate them. See Geddes v. Mining Co., 254 U. S. 599, 41 Sup. Ct. 209, 65 L. Ed. 425, and cases therein cited.
>
> "That is to say, defendant must prove that the transfers were in good faith, fair, reasonable, and for adequate consideration or at a time when, excluding them, the corporation was solvent and not contemplating insolvency; in brief, defendant must prove the transfers are not fraudulent in respect to corporate creditors."
>
> *Oliver v. Brennan*, 292 Fed. at p. 201 (affirmed, 299 Fed. 106, C. C. A. 9th).

Such showing of constructive fraud was sufficient to make out a *prima facie* case of actual intent to defraud creditors. Consequently, in this respect also, it was incumbent upon the defendants to go forward with proof of the lack of such intent, and it was the function of the trial court to determine whether or not they had sufficiently complied with this legal re-

quirement. (*Hemenway v. Thaxter,* 150 Cal. 737; *Hanscome-James-Winship v. Ainger,* 71 Cal. App. 735; *Wilson v. Robinson,* 83 Fed. (2d) 397.) Certainly it cannot be said that under the circumstances here, and still bearing in mind the nature of the wrongful acts of these corporate directors and officers, it was plaintiff's duty to show the existence of all the requirements of the fraudulent conveyance statutes at each time a misappropriation of funds was made; in other words, at the time the defendants caused each payment to be made on their note with the bank. Incidentally, the trustee testified: "The records of the Globe Drug Company, when they came into my hands, were very incomplete, very difficult to examine or ascertain anything from; we had quite a bit of trouble." (Tr. p. 65.)

THE LIABILITY OF THE DEFENDANTS RUNS TO ALL THE CREDITORS OF THE BANKRUPT.

Appellant's counsel urge that the liability here sought to be enforced runs only to the benefit of creditors existing at the time of each wrongful act, at the same time calling attention to the 1933 amendment to section 363 of the Civil Code of California. But here again they seek to confine our attention to a specific statutory declaration of directors' liability outside the scope of and beyond the fundamental common law liability here involved. The fact that a statute gives to creditors a direct remedy against directors for wrongs they commit, certainly does not affect the common law remedy of the corporation to redress those

wrongs, or the rights of a trustee in bankruptcy to recover corporate property unlawfully disposed of by directors. (See *In re Dalton Electric Co.,* 7 Fed. Supp. 465.) Under this theory of the liability of defendants, it was only necessary for plaintiff to show that at least one creditor existed at the times of the misappropriations. These directors were just as much liable, according to these legal principles, whether the corporation was insolvent or not at each and all of the times of the withdrawals. (See *Lytle v. Andrews,* 34 Fed. (2d) 252.)

Likewise, according to this theory of the liability, all of the creditors represented by the trustee, who have claims against the bankrupt estate, have a definite right to participate in any recovery from the defendants. The courts of California recognize this rule.

> "The argument that the trustee cannot bring this action on behalf of creditors whose claims were not in existence at the time of the fraud is also without merit. Subsequent creditors are entitled to recover (Sherman v. S. K. D. Oil Co. 185 Cal. 534 (197 Pac. 799); Clark v. Tompkins 205 Cal. 373 (270 Pac. 946)), and the trustee is a party authorized to sue on their behalf. (Schroeter v. Abbott, 185 Cal. 146 (196 Pac. 39); Dean v. Shingle, 198 Cal. 653 (46 A. L. R. 1156, 246 Pac 1094).)"
>
> *Kahle v. Stepens,* 214 Cal. at p. 93.

See also:

> *In re Wright Motor Company,* 299 Fed. 106;
> *Hanson v. Cal. Bank,* 17 Cal. App. (2d) 80.

THE RULES AND PRINCIPLES DECLARED IN IN RE WRIGHT MOTOR COMPANY ARE APPLICABLE TO THE INSTANT CASE.

Appellant's counsel seek to draw distinctions between the instant case and *In re Wright Motor Company,* 299 Fed. 106, C. C. A. 9th, 1924, decided in this circuit, and followed here by the lower court. They say that there is a difference in the facts involved; but we are willing to submit, without an extended discussion, that fundamentally and substantially there is a striking similarity in all those essential facts which are necessary to justify the interposition of a court of equity to redress the wrong, the character of which is the same in both cases. Counsel concede the absolute integrity of the decision in the *Wright Motor Company* case, but they say that its effect has been destroyed by *Erie Ry. Co. v. Tompkins,* and also that certain statutory liability touched upon in the opinion has been changed by subsequent legislative amendment. This, obviously, is mere sophistry. Although, in his opinion affirming the decision of the lower court, Circuit Judge Hunt did discuss certain statutory provisions in the laws of California, it is plain that he recognized that the liability there enforced existed regardless of these statutes, and that independent of them the misappropriation of the corporation's properties and assets by the defendant there was a fraud upon the creditors of the corporation. In this connection he said:

> "The rulings were based, not merely upon a liability imposed by statute, but upon the ground that it is a fraud upon the creditors of a corpora-

> tion to distribute corporate property to stockholders without providing for the payment of debts of the corporation. Sanger v. Upton, 91 U. S. 56, 23 L. Ed. 220; Schulte v. Boulevard Gardens Land Co., 164 Cal. 467, 129 Pac. 582, 44 L. R. A. (N. S.) 156, Ann. Cas. 1914B, 1013."

These principles are still fundamental in the law of the State of California and have never been changed either by the legislature or the courts.

It is plain to be seen that the *Erie Ry. Co.* case has had absolutely no effect whatever upon the *Wright Motor Company* case, for the very obvious reason that this court in that case strictly followed legal rules and principles embodied in the basic law of the State of California. There is nothing in the opinion of the court indicating otherwise, or that there was in the mind of the court any idea of departing from the California law and granting relief in accordance with any legal conception recognized exclusively in the federal courts.

THE DECREE OF THE LOWER COURT IS PROPER AND IN ACCORDANCE WITH THE REQUIREMENTS OF EQUITY PROCEDURE.

In formulating its decree the lower court followed the practice observed in the *Wright Motor Company* case. In effect, the court ordered the defendants to make restitution, to a limited extent, of the fund which they took from the corporation and appropriated to their own use. The extent of the recovery was limited to a maximum of $4500.00, which is some

what below the aggregate amount of misappropriations during the three-year period prior to the adjudication of bankruptcy. As the lower court pointed out in its opinion, there was no necessity for an accounting of the sums misappropriated, for the reason that proof of the amounts thereof was undisputed. It took judicial notice of the creditors' claims proved in the bankruptcy proceedings, as it had a right to do (*Hall v. Glenn,* 247 Fed. 997; C. C. A. 9th), and concluded that the amount of the recovery awarded was adequate for all purposes.

Appellant objects that under such decree his liability is uncertain. The same objection was made and overruled in the *Wright Motor Company* case. The decree protects the rights and interests of the appellant by providing that, if the amount necessary to pay and satisfy all just and proper claims and reasonable allowances and expenses in the bankruptcy proceedings is less than the maximum award of $4500.00, the excess shall be returned to the defendants.

Appellant intimates that a special master should have been appointed for the purposes mentioned in the decree. The bankruptcy court is an arm of the federal district court, and the Referee in Bankruptcy is the special referee of that court in all matters having to do with the administration of bankrupts' estates. Appellant further complains that he is not represented in the bankruptcy proceeding and would have no standing to contest the propriety of any claims or expense allowances. This is an inconsiderate statement. He has, as the decree provides, an interest in the res

to be administered, and therefore he is a party in interest within the purview of section 57 of the Bankruptcy Act. Also, paragraph 6 of General Order XXI affords to appellant the right of which he thinks he is deprived. The defendants are directors and stockholders of the bankrupt corporation which, under said General Order, could cause the re-examination of any claim against the estate.

CONCLUSION.

Stripped of all the superfluities discussed by appellant in his brief, it would appear that this case is after all, quite simple. There is little, if any, dispute about the essential facts. The money of the bankrupt corporation was taken and paid on the personal obligations of the defendants. It has never been paid back. There could scarcely be a clearer case of the wrongful misappropriation of a corporation's property by its directors and officers.

The defendants at the trial offered no defense worthy of the name. Here the appellant seeks to justify himself by an argumentative discussion of points of law more or less unrelated to the principal issue involved and the main question to be determined. In the conclusion to their brief counsel make the suggestion that this court's opinion on this appeal will constitute the first interpretation by any court of the meaning, validity, and effect of section 363 of the California Civil Code. However interesting a legalistic

discussion of this legislative enactment would be, in our opinion the necessity for it does not exist here. In other words, whether the lower court has committed error in making its decree, does not depend in any vital respect on the meaning and effect of this code section. The appellee might just as well offer the suggestion that this court consider the effect of section 366 of the California Civil Code, holding directors and officers liable for making loans of a corporation's money or property, which liability, under the circumstances involved in this case, would seem to exist here. We might even go farther and invite attention to section 560 of the California Penal Code, in effect declaring it to be a crime for a corporate director to concur in a wrongful distribution of corporate assets, which liability would also appear to exist here.

Since the defendants are unable to offer any justification for their misdeeds, and since their malfeasance and plain breach of duty has always been condemned under any standard of morals and good conscience, it would seem to be unnecessary in determining their liability to look any farther than to those fundamental legal principles which, from time immemorial, have always been applied to just such situations as the one involved here. As the California courts of last resort have said, no legislative act has ever changed these legal principles in that state.

The lower court has determined that these defendants must make restitution of the money which they took from the corporation for their own use instead

of using it to pay its just debts. We submit that any other determination would be in violation of the true legal principles applicable here, and that, therefore, the decree of the lower court should be affirmed.

Dated, San Francisco,
January 11, 1939.

Respectfully submitted,

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Clarence A. Shuey,
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No. 8994.

In the United States Circuit Court of Appeals

For the Ninth Circuit.

7

T. E. KLIPSTEIN,

Appellant,

vs.

HERBERT P. SEARS, Trustee in Bankruptcy of the Estate of Globe Drug Company, Inc.,

Appellee.

APPELLANT'S CLOSING BRIEF.

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No. 8994.

In the United States Circuit Court of Appeals

For the Ninth Circuit.

T. E. KLIPSTEIN,

Appellant,

vs.

HERBERT P. SEARS, Trustee in Bankruptcy of the Estate of Globe Drug Company, Inc.,

Appellee.

APPELLANT'S CLOSING BRIEF.

Statement of the Case.

Appellee's re-statement of the case in his reply brief is in general merely a reiteration, in less complete form, of the material already supplied in appellant's opening brief. Such re-statement, however, contains one or two matters which appellant believes may be misleading and which warrant correction by reference to the record.

Following the quite accurate prefatory remark that such facts have "nothing to do with the extent of the recovery sought and awarded", appellee sets out the circumstances surrounding the execution of the note by Globe Drug Company, Inc., the action against the company by Klipstein, and the execution sale of the company's tangible assets, concluding with the statement that from the proceeds of such sale Klipstein "has withheld the sum of $608.75." (Brief for Appellee, pp. 4-5.) No portion of the transcript is cited for this last assertion. In fact, the record affirmatively shows that no attempt was ever made by Klipstein to withhold any part of such moneys.

In this connection Klipstein testified that all creditors were sent notice [Tr. p. 61] and that the proceeds of the sale, less costs and expenses, were turned over to the trustee. [Tr. p. 62.] The judgment roll of the action in question, a certified copy of which was introduced as Plaintiff's Exhibit 7 [Tr. p. 56], shows that the judgment was entered on November 8, 1935, and Sears himself testified that communications were sent out to the San Francisco and Los Angeles Boards of Trade at least as early as November 4th. [Tr. p. 64.] Bankruptcy proceedings were not filed until February 14, 1936. The disposition of the proceeds of the sale is revealed from the bankruptcy schedule filed by Stelzner on behalf of the drug company [Plaintiff's Exhibit 8, Tr. pp. 57-59], from which the following table is constructed:

Gross amount received on sale......		$1,935.00
"Held by Brittan & Mack, attorneys, for the benefit of creditors"	$1,316.31	
"Held by D. D. Cornwell, deputy constable, to be returned for the benefit of creditors"........................	565.17	
		1,881.48
Balance available for "costs and expenses"		$ 53.52

This tabulation completely disposes of the contention that Klipstein "has withheld" or over attempted to withhold the sum of $608.75 or any other sum whatsoever from the estate of the drug company, even prior to the bankruptcy petition.

Appellee's statement of the case contains the further assertion that the sum of $4,500.00 fixed as the maximum recovery by the decree was "calculated by the court to be

sufficient to pay all such claims, allowances and expenses". (Brief for Appellee, p. 5.) This is an inaccurate statement of the record. In the minute order entered by the trial court upon the conclusion of the trial [Tr. pp. 24-25] a decree was ordered in favor of the plaintiff in the sum of $4,255.54 and accrued interest, representing the sums "shown to have been illegally withdrawn and paid out by the defendants". In making and entering its formal findings of fact the trial court entirely failed to find on the issue of the existence of any creditors whose claims have been filed and approved and remain unsatisfied and this failure constitutes one of appellant's main points in seeking a reversal of the decree entered (see App. Op. Br. pp. 57-58). The schedule in bankruptcy prepared by Stelzner [Plaintiff's Exhibit 8, Tr. p. 57], lists debts aggregating $11,043.87, including a claim by Klipstein on his judgment in the sum of $5,708.90. Excluding this claim, which Klipstein directed his attorneys to waive for the benefit of creditors [Tr. p. 61], the listed debts total only $5,334.97 against assets in cash and accounts receivable of $3,985.63, making the excess of liabilities over assets as shown by such schedule $1,349.34. There is no evidence anywhere in the record that any of these listed debts were ever filed or approved or that any of the listed accounts were not collected.

It therefore appears from the record that, not only did the trial court not make any such "calculation" as suggested by appellee but that no such determination could have been made in view of the entire lack of evidence. This is of course obvious from the terms of the decree entered [Tr. p. 32] by which the amount necessary to satisfy such claims, allowances and expenses is left to the determination of the referee in the bankruptcy action.

ARGUMENT.

In his opening brief appellant Klipstein attempted to present to this Court certain propositions of law believed by him to be determinative of this appeal. Many, if not most, of these propositions remain wholly unanswered in appellee's brief and will not be further argued herein.

A considerable portion of appellant's opening brief was devoted to the proposition that the rights of the parties in this action are to be determined exclusively by the substantive law of the State of California and that the definition of such rights must be found in the statutes and decisions making up two branches of that law, first, the law relating to fraudulent conveyances and second, the law relating to the duties and liabilities of directors of corporations.

Appellee admits that the law of California governs. (Brief for Appellee, p. 12.) Appellee, further, makes little more than a desultory effort to meet the argument that the proof is insufficient to warrant a recovery under the rules of law relating to fraudulent conveyances. Indeed, appellee disclaims the necessity for such proof. (Brief for Appellee, p. 21, lines 3-9.) The only portion of appellee's brief relevant to this point is that in which it is asserted that Klipstein was chargeable with fraud. This argument has been amply covered in appellant's opening brief, wherein it is contended not only that no finding of fraud was intended but that the record is barren of the "unequivocal and convincing" evidence necessary to support such an allegation. See *Marshall v. Gelfand,* 99 Fed. (2d) 85 (C. C. A. 6th, 1938). Appellee's main contention is, apparently, that a recovery against Klipstein may be sustained under some general principles of law

existing apart from, and at least partially inconsistent with, the express statutory provisions of the Civil Code of the State of California. In arguing this proposition in general terms appellee has been frequently led astray from the precise issues presented to this Court on this appeal.

The Trustee in Bankruptcy, on the Record Presented, Is Limited to the Assertion of Rights Possessed by California Creditors and All Discussion Attempting to Enlarge Such Rights by Citation of Rules Governing the Duties of Directors to Their Corporation and Its Stockholders Is Irrelevant on This Appeal.

The irrelevancy of those portions of appellee's argument devoted to a dissertation on the duties owed by directors of corporations to their corporations or to stockholders is conclusively demonstrated by each of two propositions.

In the first place, as pointed out in appellant's opening brief, no diversity of citizenship exists in this case. The District Court has jurisdiction only if Sears has alleged and proved a cause of action under the provisions of section 70(e) of the Bankruptcy Act. (See argument in appellant's opening brief at page 26.) Unless the right to recover can be sustained under that section Sears is automatically out of court as there is no other basis for jurisdiction. The rights of creditors and the rights of stockholders, or the corporation, against directors are substantially different. Appellee must build his cause of action upon the former. It follows that the discussion

in appellee's brief upon the various rights ordinarily possessed by a trustee in bankruptcy bringing suit in a state court, or in a federal court under section 23(a) of the Bankruptcy Act, is not applicable. If Sears would have any greater rights standing in the shoes of the bankrupt corporation than he would otherwise have as a representative of creditors *such rights cannot be asserted upon this appeal.* Much of appellee's argument is rendered ineffectual by the failure to make this distinction.

A further and equally compelling reason why Sears cannot assert any rights other than those possessed by creditors is that the corporation itself has no cause of action of any kind against either Stelzner or Klipstein. Globe Drug Company, Inc., was a one-man corporation. Stelzner was the beneficial owner of all of its stock except that put in Klipstein's name as security, was the president and in sole and exclusive control of the business. Under these circumstances he was free to do what he wished with the corporate assets (*Sargent v. Palace Cafe Co.,* 175 Cal. 737, 167 Pac. 146 (1917); *Scales v. Holje,* 41 Cal. App. 733, 183 Pac. 308 (1919)), subject only to the specific and limited rights assertible by creditors in the event of insolvency (see *Dominguez Land Corporation v. Daugherty,* 196 Cal. 468, 238 Pac. 703 (1925)). Appellant brought out in his opening brief that no proof of insolvency prior to the date of the adjudication in bankruptcy had been produced and appellee does not and cannot dispute this contention.

Sears' right of recovery is therefore that given to creditors by the law of California and upon the determination of the scope of such creditors' rights the decree in his favor must stand or fall.

In the Absence of Proof of a Cause of Action Under the Rules of Law Relating Generally to Fraudulent Conveyances the Rights of Creditors in This Case Are Determined by the Provisions of the General Corporation Law.

In his opening brief appellant called attention to the significant changes in the statutory provisions of the Civil Code relating to the liability of directors. This argument is dismissed summarily by appellee in accordance with his assertion that Sears' cause of action may be based upon general principles of jurisprudence and the common law apart from the express statutory provisions. This assertion entirely overlooks the fundamental point that the Court, in deciding this case, is undertaking a *decision of first impression because based on a new and radically different law of corporations.* The present corporate law is in effect a complete corporation code, changed in many basic particulars from the somewhat fragmentary condition which characterized it at the time of such decisions as *Southern California Home Builders v. Young,* 45 Cal. App. 679, 188 Pac. 586 (1920).

> "There have been three distinct periods or eras in California corporation law. The first began in 1850 with the statutes of that year. The second began with the adoption of the Civil Code, effective January 1, 1873. The third begins with the going into effect of the General Corporation Law of 1931." (6a *California Jurisprudence* (1932), Section 1, p. 37.)

The amendment of Article XII of the Constitution of 1879, in 1930, was intended to give the Legislature a free hand in reconsidering the matters contained in various provisions of the Civil Code applicable to corporations,

enacted at different times without any unified scheme, and to prepare a new and complete corporation law.

> "The purpose of this amendment is to empower the Legislature to provide, and keep up to date, a modern system of laws for the organization and regulation of corporations, better adapted to present-day economic and social conditions than the antiquated laws we now have." (Argument printed on the ballot in support of Amendment of Article XII, quoted in *Ballantine, California Corporation Laws* (1938 Edition), Section 2, p. 2.)

Following the constitutional amendment the General Corporation Law was enacted in 1931 (Stats. & Amdmts. 1931, p. 1762), now comprising sections 277 to 413 of the Civil Code. A cursory examination of the provisions of this law with regard to the liabilities of directors reveals that the new provisions are obviously intended to cover the entire field. The conditions under which a corporation is authorized to distribute its assets, by dividends, purchase of its own stock, or otherwise, are carefully enumerated (see sections 342, 346 and 348b). The conditions necessary for relief in the event of violation of any such provisions are also carefully and fully stated in section 363 and the following sections. The effect of the new provisions is described by Professor Ballantine as follows:

> "The liability of the directors for declaring or paying unauthorized dividends, or permitting the unauthorized withdrawal or distribution of assets among the shareholders in connection with the purchase of

its own shares or otherwise, is limited to cases of wilful or negligent violations of the legal limitations. The directors in such cases, except those who were absent or who caused their dissent to be entered in the minutes, are made jointly and severally liable for the benefit of creditors and other shareholders.

"By amendment in 1933 the direct liability of directors to shareholders and subscribers was eliminated and the right of action against the directors was conferred upon the corporation or its representative for the benefit 'of the shareholders and owners of shares at the time of such violation,' other than shares upon which any wrongful payment or distribution was made, 'for the full amount of any loss sustained by such holders and owners,' not exceeding the amount of the unlawful distribution. The corporation or its representative may also sue for the benefit of the creditors for its debts and liabilities existing at the time of such violation.

"The special provision with reference to the right of recovery by the corporation or its representative against directors in case of insolvency of the corporation was also eliminated in 1933 and the corporation or its representative may sue at any time for the benefit of creditors and of share owners existing at the time of the violation other than those to whom wrongful distribution was made. Any judgment creditor or creditors whose original claim arose prior to the violation may also institute an action against any or all of the directors.

"If all the creditors existing at the time of an illegal distribution, have been paid in full, they can claim no loss and other creditors have no right of action." (*Ballantine, California Corporation Laws* (1938 Edition), Section 262, pp. 257-258.)

Appellee's attempt to base a liability on some law apart from this express provision runs into two difficulties. In the first place it is obvious that the General Corporation Law of 1931 was meant to cover the entire field of directors' liability. Appellant does not contend, nevertheless, that cases might not arise to which no express provision is applicable and that in such cases it would not be proper to resort to general principles of the common law. Nor does appellant contend that appellee is limited by the express mention of section 363 in his pleading. Of course this Court could grant any relief warranted by the facts alleged regardless of the pleading of legal conclusions. Appellee is, however, in no such fortunate position. He is attempting to go outside of the Civil Code *in one of the very situations for which the Legislature has provided the conditions of recovery.*

The case of *Southern California Home Builders v. Young,* 45 Cal. App. 679, 188 Pac. 586 (1920), cited in appellee's brief, was an action by a corporation against its directors for an illegal payment of dividends, based on section 309 in the form of that section prior to the amendment of 1929 (set out in appellant's opening brief, pages 40-41). The question on appeal from a judgment in favor of the plaintiff was whether or not the trial court had correctly excluded testimony that the defendants acted in good faith. Defendants argued that section 309 was merely a codification of the existing law under which they would be liable only for active malfeasance. In affirming the judgment, contrary to such contention, the Court

found it unreasonable to suppose that in such a codification the Legislature would limit the cases of liability to three only, thus apparently excluding other cases by implication. Section 309 must therefore have been intended to extend liability in these cases by making the enumerated acts *ultra vires* and good faith immaterial. Directors might still be held liable under the general existing law in cases *other than those expressly provided for.* This case is not authority for the proposition that the Court is free to vary the liability of directors in the situation for which express statutory provision has been made. Indeed, the reasoning of the decision makes it authority for exactly the contrary proposition.

The quotation of general statements in opinions handed down prior to 1931, such as that contained in *Winchester v. Howard,* 136 Cal. 432, 64 Pac. 692 (1902), to the effect that directors are "trustees for the stockholders and indirectly for the creditors", serves merely to confuse the issue. Directors in California have not been "trustees" for creditors in any real sense, except after insolvency, since the decision in *Dominguez Land Corporation v. Daugherty, supra,* decided in 1925, and their duties in this regard are now specifically covered by statutory enactment. As pointed out above these duties cannot be enlarged by any reference to any additional duties owed to stockholders not only because none exists on the facts of this case but also because the trustee is excluded from the assertion thereof due to the jurisdictional peculiarities *of this appeal.*

There Is a Complete Failure of Proof to Support Any Recovery Under Section 363 of the Civil Code.

In his opening brief appellant contended that there was a complete failure of proof under section 363 for two reasons, first, for lack of proof that Klipstein was a director within the meaning of that section, and, second, for lack of proof of creditors existing at the time of the alleged violations, whose claims have been filed, approved, and remain unpaid.

Appellee is unable to point to anything in the record contradicting the assertion that Klipstein had absolutely no connection with or knowledge of the affairs of the drug company except long before and again long after the entire period of the withdrawals. Nor does appellee seriously contend that Klipstein was ever a *de jure* director. A subsequent change in the law requiring stock ownership by directors could not affect his status. *Rozecrans Gold Mining Co. v. Morey*, 111 Cal. 114, 43 Pac. 585 (1896). Appellee attempts to assert that Klipstein cannot take advantage of the defect in his title to office to the prejudice of third parties. This might be true only if the elements of an estoppel were pleaded and proved. There was of course no such evidence here and in the absence of such proof Klipstein is perfectly free to assert this defense, under the rule laid down by the California court in *Regan v. Albin*, 219 Cal. 357, 26 Pac. (2d) 475 (1933).

Section 363 limits liability to cases of active participation in a wilful or negligent violation of its provisions. Even in the case of *de jure* directors only those taking an affirmative part in voting for the illegal acts are liable. Mere acquiescence, even subsequent affirmance, is not enough. (See *Ballantine*, cited *supra; Western Mortgage Company v. Gray,* 215 Cal. 191, 8 Pac. (2d) 1016 (1932).

The same facts which would prevent liability upon Klipstein even if he had been a *de jure* director also operate to prevent him from initially coming within the term "director" as used in section 363 in relation to the alleged illegal distributions and the liability asserted by Sears. Admittedly he did not participate in any way in the actual withdrawal of funds. All checks to the bank were made over Stelzner's signature [Tr. p. 43] and were drawn without any previous meeting or authorization by Klipstein [Tr. p. 53]. Indeed, under the circumstances Klipstein could not have very well questioned Stelzner's actions if he had known of the withdrawals. There is no evidence anywhere in the record that he did know the source of the payments to the bank or anything at all about the company's affairs until after the last of the payments [Tr. p. 60]. The single act of October 19, 1935, from which the company suffered no injury whatever but in fact was prevented from further depletion of its assets [Tr. p. 61] cannot operate to subject Klipstein to an onerous liability for events then past in which he took no part. *Western Mortgage Co. v. Gray, supra.* The record shows that as the result of his attempt to aid his brother-in-law, Stelzner, in acquiring the drug store Klipstein has already been subjected to a monetary loss of over $5,000.00. He never received the benefit of one penny from the company or from Stelzner for his actions. He took no part and had no interest in the business. The suggestion that he might be subject to criminal liability under section 560 of the Penal Code is ridiculous on the facts.

The second point precluding relief under section 363 and relied on by appellant as calling for a reversal in this action is the complete failure to prove and the failure of the trial court to find that there exist creditors whose

claims arose prior to the alleged withdrawals, who have proved such claims in the bankruptcy proceedings and whose such claims remain unpaid.

The cases cited by appellee to sustain his contention that subsequent creditors are entitled to recover are not in point and furthermore were all decided under the disparate provisions of the former law. *Kahle v. Stephens,* 214 Cal. 89, 4 Pac. (2d) 145 (1931), involved illegal purchases of the corporation's own stock taking place between the years 1919 and 1926. The basis of the court's decision is not clear from the opinion. In support of the statement that subsequent creditors were entitled to recover the opinion cites *Sherman v. S. K. D. Oil Co.*, 185 Cal. 534, 197 Pac. 799 (1921), and *Clark v. Tompkins*, 205 Cal. 373, 270 Pac. 946 (1928), both watered stock cases where *only* subsequent creditors would have any cause of complaint. Moreover, in the *Kahle* case the trustee, suing in the state court, could assert any rights possessed by the corporation and there was evidence of a large number of innocent shareholders. There was in addition abundant evidence of actual fraud.

Hansen v. California Bank, 17 Cal. App. (2d) 80, 61 Pac. (2d) 794 (1936), also involved an illegal purchase of stock, taking place under section 309 as it existed in 1929 (set out in App. Op. Br. p. 41). On the authority of the *Kahle* case the court found subsequent creditors entitled to recover upon the theory that the money received upon the sale to the corporation of its own stock without the consent of the Corporation Commissioner created a trust fund, the transaction being *ultra vires* and void.

Besides involving questions different from that here raised both the *Kahle* case and the *Hansen* case are no longer law in the State of California since the amendment of section 363 in 1933. The plain words of that section

as so amended restrict recovery to existing creditors. The rather lengthy quotation above set out from Ballantine entirely bears out appellant's contentions in this regard and the point will not be argued further.

Appellee makes the statement (Brief for Appellee, p. 25) that the trial court took judicial notice of the creditors' claims proved in the bankruptcy proceedings. Even if this were true it would of course not remedy the failure to show that such creditors were in existence at the time of the alleged violations and appellee does not attempt this contention. However, the assertion concerning judicial notice is clearly only an afterthought. There is nothing in the record to show that the trial court took such notice or that there were in existence records of which such notice could be taken. On the contrary the record affirmatively shows that no such notice was taken inasmuch as by the decree the amount of the recovery depends upon the report of the referee in the bankruptcy proceedings *to be thereafter filed* in the present action. An issue of fact was tendered as to the existence of unpaid creditors who had proved their claims [see Amended Complaint, paragraphs VIII, Tr. p. 8, and III, Tr. p. 10; Answer, paragraphs VIII, Tr. p. 12, and XI, Tr. p. 13]. No proof was introduced on this issue nor was the court asked to take judicial notice of any such facts. The record shows that no such notice was taken. If the trial court had attempted to supply the lack of proof by any such means the propriety of its action would have been highly doubtful. *Paridy v. Caterpillar Tractor Co.*, 48 Fed. (2d) 166 (C. C. A. 7th, 1931); *In re Interstate Oil Corporation*, 63 Fed. (2d) 674 (C. C. A. 9th, 1933).

Appellant will not further argue the effect of the decision in *In re Wright Motor Company*, 299 Fed. 106

(C. C. A. 9th, 1924), upon which the trial court based its decision in the instant case. It is felt that the unavailability of that case to support the decree herein is sufficiently set forth in appellant's opening brief and that the arguments therein contained remain entirely unanswered. The other cases cited by the appellee, *In re Dalton Electric Co.*, 7 Fed. Supp. 465 (1934), and *Lytle v. Andrews*, 34 Fed. (2d) 252 (C. C. A. 8th, 1929), are based upon the local laws of the states of Mississippi and Iowa respectively and, particularly since the decision in *Erie Railroad Co. v. Tompkins*, 304 U. S. 64, 58 S. Ct. 817 (1938), can afford little aid to appellee in this litigation.

In No Event Would the Trustee in Bankruptcy Be Entitled to Recover "Reasonable Allowances and Expenses" Over and Above the Amount of Any Unpaid Creditors Claims.

In its decree the trial court allowed recovery not only to the extent sufficient to satisfy all claims approved but also sufficient to cover all "reasonable allowances and expenses" in the bankruptcy proceedings, to be determined by a report to be filed by the referee [Tr. p. 33]. No matter what decision might be rendered on the other questions presented on this appeal the impropriety of this action is obvious. Appellee has cited no authority and appellant knows of none which could support a recovery over and above the amount of unpaid creditors claims, under any circumstances. Not only is the additional recovery legally unwarranted but Klipstein would by the decree be denied his day in court to contest the reasonableness of any items sought to be included under the vague and indefinite denomination of "allowances and expenses."

Conclusion.

This Court on this appeal from an equitable decree is confronted with the problem of considering the evidence and rendering a decision by the application to such evidence of statutory provisions hitherto not authoritatively interpreted. Yet the very questions vital to a determination of the legal issues involved are left unanswered by the proof adduced at the trial and preserved in the record. When, if ever, prior to the date of its adjudication in bankruptcy, did the Globe Drug Company first become unable to meet its obligations as they fell due? Were any claims of creditors allowed in the bankruptcy proceedings and if so, to what extent, and when did such claims accrue? These and other questions raised by the pleadings are vital to the decision in this case and are left entirely unanswered by the evidence produced by plaintiff in support of his case. Appellee now seeks to avoid this failure by wholesale inferences and resort to principles of law applied "from time immemorial" "to just such situations as this". The express statutory enactments governing such cases are apparently considered mere impediments to the application of these principles. But no law applies except the law of the State of California, determined by the statutes enacted by its Legislature and the decisions of its Courts. The principles which appellee seeks to apply seem to exist only *in vacuo,* not having their origin in the instrumentalities empowered to make and apply the substantive law of the State.

The failure to supply the conditions of relief expressly provided cannot be remedied by such vague and unsubstantial legal principles, unsupported by citation to statutes or decisions. The lack of proof on essential elements of plaintiff's case requires a reversal of the decree entered by the trial court.

Respectfully submitted,

HOMER JOHNSTONE,
SIDNEY H. WYSE,
Attorneys for Appellant.

No. 8994.

In the United States Circuit Court of Appeals

For the Ninth Circuit.

8

T. E. Klipstein,

Appellant,

vs.

Herbert P. Sears, Trustee in Bankruptcy of the Estate of Globe Drug Company, Inc.,

Appellee.

PETITION FOR REHEARING.

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Parker & Baird Company, Law Printers, Los Angeles.

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No. 8994.

In the United States Circuit Court of Appeals

For the Ninth Circuit.

T. E. KLIPSTEIN,

Appellant,

vs.

HERBERT P. SEARS, Trustee in Bankruptcy of the Estate of Globe Drug Company, Inc.,

Appellee.

PETITION FOR REHEARING.

To the Honorable Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

T. E. Klipstein, appellant in the above cause, respectfully requests a rehearing of the appeal in said cause, for the purpose of more fully considering the jurisdictional questions and other matters set forth in this petition.

In its opinion sustaining the decree of the District Court, this Court rested its decision not upon either of the two theories of liability set out in the pleadings and extensively argued at the trial and in the briefs, but upon Section 366 of the Civil Code of California, a statutory provision not previously considered in the case.

The grounds of this petition are that, in basing its decision on this section, this Court sustained a recovery not warranted by the facts, on a cause of action over which the District Court does not have jurisdiction.

In the Absence of Diversity of Citizenship, the District Court Has No Jurisdiction Over an Action by a Trustee in Bankruptcy Under Section 366 of the Civil Code.

In the opinion of this Court liability is sustained under Section 366 of the Civil Code. The nature of plaintiff's cause of action under this section is described as follows:

> "This is a suit to enforce a right of the corporation by the trustee against the director for his illegal acts. Whether the stockholders of the bankrupt or its creditors will benefit by recovery is of no moment here. The right enforced exists whether there are creditors or not." (Opinion, p. 7.)

Such a cause of action is one over which the federal courts have no jurisdiction in the absence of diversity of citizenship. This conclusion follows from well settled principles of federal jurisprudence.

The federal courts are courts of limited jurisdiction. There is a continuing presumption against the existence of such jurisdiction and a continuing burden upon the proponent to overcome such presumption, on the record, when the question is raised at any time. (*Turner v. Bank of North America*, 4 U. S. 8, 1 L. Ed. 718 (1799); *McNutt v. General Motors Acceptance Corporation*, 298 U. S. 178, 56 S. Ct. 780 (1936); *Celite Corporation v. Dicalite Company*, 96 Fed. (2d) 242 (C.C.A. 9th, 1938), *cert. den.* 59 S. Ct. 101; *Royalty Service Corporation v. City of Los Angeles*, 98 Fed. (2d) 551 (C.C.A. 9th, 1938). In the instant case this objection was, of course, made throughout. [See Assignment of Errors, No. I, Tr. p. 71; No. VII, Tr. p. 76; No. XX, Tr. p. 85.]

Under the provisions of the National Bankruptcy Act in effect at the time of the transactions here in question (Act of July 1, 1898, c. 541, 40 Stats. 565, as amended to 1936), a trustee can sue in the federal courts only when the bankrupt himself could so have sued, subject to three expressly provided exceptions. (*Matthew v. Coppin*, 32 Fed. (2d) 100 (C.C.A. 9th, 1929); *In re Prima Company*, 98 Fed. (2d) 952 (C.C.A. 7th, 1938); *Cook v. Glover*, 22 Fed. Supp. 531 (D. C. E. D. Ill., 1938.)

The applicable provisions of the Act are contained in Sections 23, 60 (b), 67 (e) and 70 (e). Section 23 reads as follows:

> "Section 23. a. The United States district courts shall have jurisdiction of all controversies at law and in equity, as distinguished from proceedings in bankruptcy, between trustees as such and adverse claimants concerning the property acquired or claimed by the trustees, in the same manner and to the same extent only as though bankruptcy proceedings had not been instituted and such controversies had been between the bankrupts and such adverse claimants.
>
> "b. Suits by the trustee shall be brought or prosecuted only in the courts where the bankrupt, whose estate is being administered by such trustee, might have brought or prosecuted them if proceedings in bankruptcy had not been instituted, unless by consent of the proposed defendant, except suits for the recovery of property under section 60, subdivision b; section 67, subdivision e; and section 70, subdivision e."

There is no question but that this action is a plenary suit as distinguished from "proceedings in bankruptcy".

Compare appellee's brief, page 5; *In re Prima Company, supra.* Nor is there any question of "consent". See *Matthew v. Coppin, supra.*

Of the three types of suits excepted from the general rule only one, that provided by Section 70 (e), could be relied on by appellee here. Section 60 (b) relates only to transfers of property or judgments made or suffered by the bankrupt, within four months of bankruptcy, while insolvent. In such cases the trustee may recover the property transferred or avoid the judgment. Here, the opinion of this Court expressly recognizes the lack of any evidence of insolvency. Moreover, there was, of course, no property transferred within the four months period, the assets of the bankrupt not being reduced by the execution of the note which was never paid and was returned by Klipstein to the corporation. [Tr. p. 61.] The only right the trustee might have in any event under Section 60 (b) would be to invalidate the judgment obtained by Klipstein against the bankrupt. This relief could, of course, be granted in these proceedings but the question is moot as the claim based on the judgment was waived. [Tr. p. 61.]

Section 67 (e), not relied on by Sears (see Appellee's Br. p. 5) concerns transfers of property made while insolvent or with intend to defraud creditors, both of which circumstances are explicitly found lacking by this Court in its opinion.

It follows that jurisdiction does not exist in this case unless appellee has pleaded and proved a cause of action

under Section 70 (e) of the Act. This section reads as follows:

> "Section 70. e. The trustee may avoid any transfer by the bankrupt of his property which any creditor of such bankrupt might have avoided, and may recover the property so transferred, or its value from the person to whom it was transferred. . . . For the purpose of such recovery any court of bankruptcy as hereinbefore defined, and any State court which would have had jurisdiction if bankruptcy had not intervened, shall have concurrent jurisdiction."

The crucial question is therefore whether or not the cause of action created by Section 366 of the Civil Code is one assertible by creditors of the affected corporation. A negative answer to this question is implicit in the portion of the opinion of this Court quoted *supra* in this petition.

Section 366 creates a liability dependent solely upon the consent or lack of consent of a certain proportion of the voting shares of a corporation, not upon solvency or insolvency, or the existence or absence of creditors. In the absence of other circumstances, such as insolvency, no creditor could complain of any loan or guaranty made in violation of Section 366. It would certainly be an anomaly to hold that creditors had a cause of action under this section, which right was subject to defeat by the consent of stockholders of a corporation to a transaction otherwise illegal. (Compare the analogous provisions of the Bank Act, 1909 Stat. & Amdts., p. 87, as

amended, General Laws of California (Deering, 1937), Act 652, Sections 65 and 83.)

Reference to the surrounding sections of the Civil Code confirms this interpretation. Sections 363, 364 and 365 cover situations where creditors are affected and in each of these sections creditors are specifically mentioned and their remedies prescribed. Such provisions are significantly omitted from Section 366 and the succeeding sections, which relate purely to infra-corporate matters.

It seems obvious, therefore, that the liability created by Section 366 is a liability to the corporation and that no creditor could attack transactions in violation of that section if the corporation itself acquiesced therein. The remedy created is simply an action by the corporation against any implicated director upon a guaranty implied in law by reason of such director's "illegal acts". There is involved no transfer which any creditor might avoid within the meaning of Section 70 (e) of the Bankruptcy Act (or any action "null and void as against the creditors" within the meaning of Section 67 (e), if that section otherwise applied). See, in general, *Dominguez Land Corporation v. Daugherty*, 196 Cal. 468, 238 Pac. 703 (1925).

The federal courts have no jurisdiction over such an action, when brought by a trustee in bankruptcy, unless diversity of citizenship is present. (*Park v. Cameron,* 237 U. S. 616, 35 S. Ct. 719 (1915); *Kelley v. Gill,* 245 U. S. 116, 38 S. Ct. 38 (1917); *Carmichael v. Barrett,* 28 Fed. (2d) 692 (C.C.A. 5th, 1928); *Lowenstein v. Reikes,* 60 Fed. (2d) 933 (C.C.A. 2d, 1932), *cert. den.* 287 U. S. 669, 53 S. Ct. 315; *Siegel v. Municipal Capital Corporation,* 102 Fed. (2d) 905 (C.C.A. 2d, 1939).

No Cause of Action Exists in Any Event Under Section 366, on the Facts of This Case.

Apart from the question of the lack of jurisdiction, no recovery could be sustained in any court under Section 366, on the facts of this case. That section imposes liability only where certain actions are taken without the consent of two-thirds of the stock held by persons not involved. Here all the stock of the bankrupt, except that held as security by Klipstein, was beneficially owned by Stelzner. [Tr. p. 55.] The corporation itself has no complaint under these circumstances. (*Sargent v. Palace Cafe Co.,* 175 Cal. 737, 167 Pac. 146 (1917); *Scales v. Holje,* 41 Cal. App. 733, 183 Pac. 308 (1919).) Moreover, Section 366 provides that the offending persons are liable to the corporation "as guarantors" for the repayment of the loan or to the extent necessary to hold the corporation harmless from any prohibited guaranty. Here, since no money left the corporation, there was nothing to repay. Nor did the corporation suffer liability by guaranteeing the obligation of Stelzner and Klipstein, if the transaction could be so construed. It suffered only a judgment which was never paid, all rights under which have been waived, and which in no way injured the corporation or operated as a preference. As a matter of fact it is admittedly true that Globe Drug Company never suffered injury in any way by any act of Klipstein in connection with the note executed on October 19, 1935, or by any subsequent act. Appellee has not contended otherwise.

This case was tried to determine the question whether any liability existed by reason of the withdrawals of cash from the bankrupt to apply upon the Stelzner note. The trial court heard the evidence and concluded as a matter of law that "all the payments made out of said corporation's funds" were illegal, and gave judgment accordingly. The briefs filed by both parties take up at length the law applicable to the question of liability based on the fact of such payments.

This Court, in its opinion, based its affirmance not on the fact of such cash withdrawals, heretofore regarded as the sole basis of liability, but upon other facts and circumstances, characterized by appellee himself as "having nothing to do with the extent of the recovery sought and awarded" (Br. p. 3), and not adequately briefed. Appellant Klipstein respectfully requests that the appeal be reheard for the purpose of more fully presenting the new questions raised by the decision of this Court, and particularly for consideration of appellant's contention that by changing the cause of action from one assertible by creditors to one assertible only by the bankrupt itself, the sole basis for federal jurisdiction under the Bankruptcy Act immediately ceases.

Respectfully submitted,

Homer Johnstone,

Sidney H. Wyse,

Attorneys for Appellant.

1204 Bartlett Bldg., Los Angeles, California,

Certificate of Counsel.

The undersigned, attorneys for the appellant in the above cause, do hereby certify that in our judgment the above and foregoing petition is well founded and that it is not interposed for the purpose of delay.

HOMER JOHNSTONE,

SIDNEY H. WYSE,

Attorneys for Appellant.

No. 9007

United States
Circuit Court of Appeals
For the Ninth Circuit.

BETTY ROGERS,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent,

and

BETTY ROGERS, O. N. BEASLEY, OSCAR LAWLER, JAMES K. BLAKE, Executors of the Estate of WILL ROGERS, Deceased,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Transcript of the Record

Upon Petitions to Review Decisions of the United States Board of Tax Appeals

PARKER PRINTING COMPANY. 545 SANSOME STREET. SAN FRANCISCO

No. 9007

United States

Circuit Court of Appeals

For the Ninth Circuit.

ETTY ROGERS,

Petitioner,

vs.

OMMISSIONER OF INTERNAL REVENUE,

Respondent,

and

ETTY ROGERS, O. N. BEASLEY, OSCAR LAWLER, JAMES K. BLAKE, Executors of the Estate of WILL ROGERS, Deceased,

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PARKER PRINTING COMPANY, 545 SANSOME STREET, SAN FRANCISCO

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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APPEARANCES:

or Petitioner:

CLAUDE I. PARKER, Esq.,
JOHN B. MILLIKEN, Esq.,
BAGLEY KOHLMEIER, Esq.,
L. A. LUCE, Esq.,

'or Respondent:

D. M. EVANS, Esq.

Docket No. 84895

ETTY ROGERS,

Petitioner,

vs.

OMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES:

1936

Iay 29—Petition received and filed. Taxpayer notified. (Fee paid)

Iay 29—Copy of petition served on General Counsel.

une 30—Answer filed by General Counsel.

uly 1—Copy of answer served on taxpayer.

1937

uly 20—Hearing set week beginning 9/27/37, Los Angeles, California.

1937

Sept. 27—Hearing had before Mr. Mellott on merits. Submitted.

Stipulation of facts filed. Taxpayer's brief due 11/11/37—respondent's brief due 12/11/37—reply due 12/27/37.

Nov. 10—Transcript of hearing 9/27/37 filed.

Nov. 10—Brief filed by taxpayer. 11/11/37 copy served.

Dec. 9—Brief filed by General Counsel.

1938

Jan. 10—Motion for leave to file brief filed by taxpayer—brief lodged. 1/11/38 granted.

Jan. 12—Copy of motion and reply brief served on General Counsel.

May 18—Opinion rendered—Arthur J. Mellott, Division 11. Judgment will be entered for the respondent.

May 19—Decision entered—Arthur J. Mellott, Division 11.

May 20—Order that last paragraph of opinion promulgated 5/18/38 be corrected, entered Arthur J. Mellott, Division 11.

Aug. 13—Petition for review by U. S. Circuit Court of Appeals, Ninth Circuit, with assignments of error filed by taxpayer.

Aug. 13—Proof of service filed by taxpayer.

1938

Sept. 24—Certified copy of order from Ninth Circuit consolidating with 84896 for briefing and decision upon a single consolidated transcript of record consisting of such portions of the record before the Board as the parties herein may indicate by their praecipes for record—copy of this order to be incorporated in record—filed.

Sept. 29—Agreed statement of evidence lodged.

Sept. 29—Praecipe for record filed with proof of service thereon.

Sept. 30—Order approving statement of evidence—statement ordered filed—entered. [1*]

APPEARANCES:

For Petitioners:

CLAUDE I. PARKER, Esq.,
JOHN B. MILLIKEN, Esq.,
BAGLEY KOHLMEIER, Esq.,
L. A. LUCE, Esq.

For Respondent:

D. M. EVANS, Esq.

*Page numbering appearing at the foot of page of original certified Transcript of Record.

Docket No. 84896

BETTY ROGERS, O. N. BEASLEY, OSCAR LAWLER, JAMES K. BLAKE, EXECUTORS OF THE ESTATE OF WILL ROGERS DECEASED,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES:

1936

May 29—Petition received and filed. Taxpayer notified. (Fee paid)

" 29—Copy of petition served on General Counsel.

June 30—Answer filed by General Counsel.

July 1—Copy of answer served on taxpayer.

1937

July 20—Hearing set week beginning 9/27/37, Los Angeles, California.

Sep. 27—Hearing had before Mr. Mellott on merits. Submitted. Stipulation of facts filed. Briefs due: Taxpayer's 11/11/37—respondent's 12/11/37—reply 12/27/37.

Nov. 10—Transcript of hearing 9/27/37 filed.

" 10—Brief filed by taxpayer. 11/11/37 copy served.

Dec. 9—Brief filed by General Counsel.

1938

an. 10—Motion for leave to file reply brief filed by taxpayer—reply brief lodged. 1/11/38 granted.

" 12—Copy of motion and reply brief served on General Counsel.

Iay 18—Opinion rendered—Arthur J. Mellott, Division 11. Judgment will be entered for the respondent.

" 19—Decision entered—Arthur J. Mellott, Division 11.

" 20—Order that last paragraph of opinion promulgated 5/18/38 be corrected entered—Arthur J. Mellott, Division 11.

ug. 13—Petition for review by U. S. Circuit Court of Appeals, Ninth Circuit, with assignments of error filed by taxpayer.

" 13—Proof of service filed by taxpayer.

ep. 24—Certified copy of order from Ninth Circuit consolidating with 84895 for briefing and decision upon a single consolidated transcript of record consisting of such portions of the record before the Board as the parties herein may indicate by their praecipes for record—copy of this order to be incorporated in record—filed.

" 29—Agreed statement of evidence lodged.

" 29—Praecipe for record filed with proof of service thereon.

" 30—Order approving statement of evidence—statement ordered filed—entered. [2]

United States Board of Tax Appeals
Docket No. 84895

BETTY ROGERS,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION

The above named petitioner hereby petitions for redetermination of the deficiency set forth by th Commissioner of Internal Revenue in his notice o deficiency IT:AR:E-1 ML-90D, dated March 4 1936, and as a basis for this proceeding alleges a follows:

1. Petitioner is an individual residing in th City of Beverly Hills, State of California.

2. The notice of deficiency (a copy of which i attached hereto and marked Exhibit A) is date March 4, 1936, and was presumably mailed on tha date.

3. The taxes in controversy are income taxes o petitioner for the calendar year 1933 in the amour of $17,055.90.

4. The determination of the tax set forth in th notice of deficiency is based upon the followin errors:

(a) Respondent erred in determining tha the loss sustained by petitioner and her hus

band Will Rogers during the year 1933 in the amount of $54,055.25 in connection with the cancellation of a certain contract to purchase real property [3] and the forfeiture of the payments theretofore made on the purchase price of said property was a capital loss.

(b) Respondent erred in refusing to allow deduction of said loss as an ordinary loss in computing the tax liability of petitioner for the calendar year 1933.

(c) Respondent erred in treating such loss as a capital loss in recomputing the tax liability of petitioner for the calendar year 1933.

5. The facts upon which petitioner relies as the asis for this proceeding are as follows:

(a) During September, 1927, petitioner and her husband, Will Rogers, purchased certain real property in the County of Los Angeles, State of California, described as follows:

> Lots 163 and 164, Tract 1719, as per Map recorded in Book 21, Pages 162 and 163 of Maps, in the office of the County Recorder of Los Angeles County, State of California.

The total purchase price of said property was $105,000.00 payable as follows: $15,000.00 in cash at the time of the purchase; the assumption of a note in the amount of $52,000.00 secured by a mortgage on said property and due

and payable in 1930, and the giving of a promis sory note for the balance of $38,000.00 to be se cured by a Trust Deed on said property.

Petitioner and her husband, Will Rogers paid said $15,000.00, assumed the payment o said $52,000.00 note, and executed and delivere to the seller their promissory note for $38,000.0 payable in 1932. In September, 1927, said prop erty was conveyed to petitioner and her hus band Will Rogers, and they conveyed said prop erty to the [4] Title Guarantee and Trust Com pany as trustee, as security for the payment o said $38,000.00 note. Said property was acquire as community property of petitioner and he husband Will Rogers. Said property was busi ness property and the transaction was entere into for a profit.

(b) Prior to April 21, 1933 petitioner and her husband, Will Rogers, paid in full said note for $52,000.00 which they had assumed. On April 21, 1933 said property was reconveyed by said trustee to petitioner and her husband Wil Rogers and they immediately conveyed said property to the party from whom they had purchased it in 1927. The said note for $38,000.00 was cancelled and petitioner and her husband Will Rogers forfeited said property and al payments made toward the purchase thereof.

(c) Prior to April 21, 1933 petitioner and her husband Will Rogers paid $67,000.00 to-

ward the purchase of said property and in addition thereto said escrow expenses in the amount of $212.02, making a total of $67,212.02. For the years 1927 to 1932, inclusive, they claimed and were allowed depreciation on the improvements on said property in the total amount of $13,156.77. The total unrecovered cash investment in said property at the time of the forfeiture and reconveyance to the seller was $54,055.25. Petitioner and her husband Will Rogers each sustained a loss in 1933 from said transaction in the amount of to-wit, $27,027.62. [5]

(d) Petitioner and her husband Will Rogers filed separate income tax returns for the calendar year 1933. In her income tax return for 1933 petitioner computed the loss on said transaction to be $57,643.46 and deducted one-half of said sum, or $28,821.73 as an ordinary loss in computing her net taxable income for said year. Respondent has disallowed the deduction of said loss as an ordinary loss and has determined that it was a capital loss and has treated it as a capital loss in recomputing the tax liability of petitioner for the year 1933. The deficiency herein in controversy results from respondent's determination that said loss was a capital loss.

Wherefore petitioner prays that the Board may hear and determine this appeal.

CLAUDE I. PARKER
JOHN B. MILLIKEN
BAYLEY KOHLMEIER
Attorneys for petitioner
808 Bank of America Bldg.
Los Angeles, Calif.

Of Counsel:
L. A. LUCE
937 Munsey Building,
Washington, D. C.

State of California
County of Los Angeles—ss.

Betty Rogers, being first duly sworn, deposes and says; that she is the petitioner in the foregoing petition; that she is familiar with the facts stated therein and the facts so stated are true and correct, except such facts as are stated upon information and belief and those facts she believes to be true.

BETTY ROGERS

Subscribed and sworn to before me this 25th day of May, 1936.

CATHERINE A. MACK
Notary Public in and for said county and state. [6]

EXHIBIT A

Treasury Department
Washington

Mar. 4, 1936

)ffice of
'ommissioner of Internal Revenue

ddress reply to
'ommissioner of Internal Revenue
nd refer to
T:AR:E-1
IL-90D

Irs. Betty Rogers,
407 Bank of America Building,
Beverly Hills, California.

Iadam:

You are advised that the determination of your ncome tax liability for the taxable year(s) 1933 iscloses a deficiency of $17,055.90, as shown in the tatement attached.

In accordance with section 272 (a) of the Reve-ue Act of 1932, as amended by section 501 of the Revenue Act of 1934, notice is hereby given of the eficiency mentioned. Within ninety days (not ounting Sunday or a legal holiday in the District f Columbia as the ninetieth day) from the date of he mailing of this letter, you may file a petition vith the United States Board of Tax Appeals for a edetermination of the deficiency.

Should you not desire to file a petition, you are equested to execute the enclosed form and forward

it to the Commissioner of Internal Revenue, Wash ington, D. C., for the attention of IT:C:P-7. Th signing and filing of this form will expedite th closing of your return by permitting an early as sessment of the deficiency and will prevent the ac cumulation of interest, since the interest perio terminates thirty days after filing the form, or o the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING

Commissioner.

By (Signed) CHAS. T. RUSSELL

Deputy Commissioner.

Enclosures:

Statement

Form 870 [7]

STATEMENT

IT:AR:E-1

ML-90D

In re: Mrs. Betty Rogers,
407 Bank of America Building,
Beverly Hills, California.

Income Tax Liability

Year—1933

Income Tax Liability—$70,371.20

Income Tax Assessed—$53,315.30

Deficiency—$17,055.90

The deficiency shown herein is based upon the re port dated October 23, 1935, prepared by Revenue

Agent P. Blackford, a copy of which was transmitted to you.

Careful consideration has been accorded your protest dated December 27, 1935, in connection with findings of the examining officer, and the information submitted at a conference held in the office of the internal revenue agent in charge.

The return has been adjusted as follows:

Net Income

Net income reported on the return		$141,098.76
Add:		
(1) Salary	$ 3,576.47	
(2) Reduction of business losses	2,867.70	
(3) Loss on disposition of property	28,821.73	
(4) Contributions	400.00	
(5) Fiduciary income	340.00	36,005.90
Ordinary net income adjusted		$177,104.66
Capital net loss reported	0	
(6) Capital net loss allowed		$ 27,027.62

[8]

Computation of Tax

Net income subject to surtax	$177,104.66
Less:	
Personal exemption (total amount claimed by husband)	0
Balance subject to normal tax	$177,104.66
Normal tax at 4% on $4,000.00	$ 160.00
Normal tax at 8% on $173,104.66	13,848.37
Surtax on $177,104.66	59,741.28
Tax at 12½% on capital net loss of $27,027.62	(3,378.45)
Corrected income tax liability	$ 70,371.20
Income tax assessed:	
Account No. 809994	53,315.30
Deficiency in tax	$ 17,055.90

Explanation of Changes

(1) In the deductions from gross salaries received the following items have been disallowed:

(a) The amount of $500.00 paid to Friar's Club for a certificate of indebtedness, representing an investment, has been disallowed.

(b) The travel expense deduction has been adjusted to eliminate the following:

Personal expenses charged on hotel bills	$ 961.08
Accident insurance while traveling in airplanes, a personal expense	3,075.50
Account #121, consisting of "cash" checks for personal use while not traveling	2,400.00
Total disallowed	$6,436.58

[9]

(c) The amount claimed as depreciation on a Cadillac automobile has been corrected to allow 50% for business use instead of 75%, resulting in a disallowance of 1/3 of $649.08, or $216.36.

Summary:

Amount paid for certificate of indebtedness	$ 500.00
Travel expenses	6,436.58
Depreciation	216.36
Total	$7,152.94
One-half applicable to husband's return	$3,576.47
One-half applicable to wife's return	$3,576.47

(2) Losses from business have been reduced as follows:

(a) Depreciation on Oklahoma ranches has been reduced from $3,428.77 to $2,445.41, a difference of $983.36.

(b) The loss on Santa Monica ranch has been reduced by $4,752.03 as follows:

The deduction for maintenance of a tennis court has been disallowed as a personal expense	$ 215.45
One-half of compensation insurance has been disallowed as being personal	218.50
The insurance on the residence and furnishings is a personal expense	1,112.40
One-half of the foreman's salary is disallowed as a personal expense	1,500.00
Depreciation on livestock has been disallowed, because fully depreciated prior to 1933	720.00
One-half of the depreciation of $1,971.36 on trucks, tractor, and buildings has been disallowed as being personal	985.68
Total disallowed on Santa Monica Ranch	$4,752.03

[10]

Brought forward	$4,752.03
Total disallowed on Oklahoma Ranches	983.36
Total disallowed on ranches	$5,735.39
One-half applicable to husband's return	$2,867.69
One-half applicable to wife's return	$2,867.70

(3) See (6) below.

(4) The following contributions have been disallowed as not deductible under the provisions of section 23(n) of the Revenue Act of 1932:

Ruby Adams Benefit	$ 200.00
Prescott Frontier Days	100.00
Fox Studio Employees	500.00
Total	$ 800.00
One-half applicable to husband's return	$ 400.00
One-half applicable to wife's return	$ 400.00

(5) Interest of $340.00 was received from Trust #616, Beverly Hills National Bank and Trust Company.

(6) and (3) The loss on the disposition of Bundy Bath House property has been adjusted to take into consideration

the depreciation which was allowable in 1927 and 1928, and has been held to be a capital loss rather than an ordinary loss.

Total loss as claimed		$57,643.46
Loss decreased on account of depreciation allowable:		
1927 (½ year)	$1,196.07	
1928	2,392.14	3,588.21
Loss as corrected		$54,055.25
Husband's loss		$27,027.63
Wife's loss		$27,027.62

[11]

It is held that the transaction whereby you and your husband transferred all your right, title and interest in the Bundy Bath House property to Pacific Palisades Corporation in 1933 in consideration of the corporation's having cancelled and returned to you the note for $38,000.00 which you gave in part payment therefor in 1927, amounted to an exchange of one asset for another asset, real estate for the trust deed note. Accordingly, the loss on the disposition is considered to be a capital loss falling under the provisions of section 101 of the Revenue Act of 1932. Having acquired full title to the property in 1927, you and your husband upon reconveying the property to the Pacific Palisades Corporation sustained a loss comparable to the loss which you would have suffered if you had lost the property through process of law. Such a case was con-

sidered in General Counsel Memorandum 12737 (Internal Revenue Cumulative Bulletin XIII-1, 120), and it was held that the resulting loss was a capital loss.

Due to the fact that the expiration of the period provided in the statute of limitations will presently bar any assessment of additional tax on the return filed for the year 1933, the Income Tax Unit will be unable to afford you an opportunity to protest this determination or to be accorded a hearing prior to the mailing of this statutory notice of deficiency.

Copies of this letter have been mailed to your representatives, Mr. George H. Koster, Bank of America Building, Los Angeles, California, and Mr. L. A. Luce, Munsey Building, Washington, D. C. in accordance with the authority conferred upon them in powers of attorney on file with the Bureau.

[Endorsed]: U.S.B.T.A. Filed May 29, 1936. [12]

[Title of Board and Cause.]

ANSWER

Comes Now the Commissioner of Internal Revenue by his attorney, Herman Oliphant, General Counsel for the Department of the Treasury, and for answer to the above-styled petition admits and denies as follows:

1, 2, and 3. Admits the allegations contained in Paragraphs 1, 2, and 3 of the petition.

4(a), (b) and (c). Denies that the Commissioner erred as alleged in subparagraphs (a), (b), and (c) of Paragraph 4 of the petition.

5(a) to (d), inclusive. Denies the allegations contained in subparagraphs (a) to (d), inclusive, of Paragraph 5 of the petition.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore admitted, qualified, or denied.

Wherefore, it is prayed that the appeal be denied.

(Signed) HERMAN OLIPHANT
General Counsel for the
Department of the Treasury.

Of Counsel:
B. H. NEBLETT,
HAROLD F. NONEMAN,
Special Attorneys,
Bureau of Internal Revenue.

[Endorsed]: U.S.B.T.A. Filed June 30, 1936. [13]

United States Board of Tax Appeals
Docket No. 84896

BETTY ROGERS, O. N. BEASLEY, OSCAR LAWLER, JAMES K. BLAKE, EXECUTORS OF THE ESTATE OF WILL ROGERS, DECEASED,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION

The above named petitioners hereby petition for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency IT:AR:E-1 ML-90D, dated March 4, 1936, and addressed to Mr. J. K. Blake, Co-executor of the Estate of Will Rogers, deceased, and as a basis for this proceeding allege as follows:

1. Petitioners are individuals residing in the County of Los Angeles, State of California, and are the duly appointed, qualified and acting Executors of the Estate of Will Rogers, deceased. Decedent, a resident of the City of Beverly Hills, California, died testate on August 15, 1935. On September 17, 1935, petitioners were duly appointed executors of the estate of Will Rogers, deceased, by the Superior Court of the State of California, in and for the County of Los Angeles. [14]

2. The notice of deficiency (a copy of which is attached hereto and marked Exhibit A) is dated March 4, 1936, and was presumably mailed on that date.

3. The taxes in controversy are income taxes of Will Rogers, deceased, for the calendar year 1933 in the amount of $16,894.61.

4. The determination of the tax set forth in the notice of deficiency is based upon the following errors:

(a) Respondent erred in determining that the loss sustained by Will Rogers and his wife,

Betty Rogers, during the year 1933, in the amount of $54,055.25 in connection with the cancellation of a certain contract a purchase real property and the forfeiture of the payments theretofore made on the purchase price of said property was a capital loss.

(b) Respondent erred in refusing to allow deduction of said loss as an ordinary loss in computing the tax liability of Will Rogers for the calendar year 1933.

(c) Respondent erred in treating such loss as a capital loss in recomputing the tax liability of Will Rogers for the calendar year 1933.

5. The facts upon which petitioners rely as the basis for this proceeding are as follows:

(a) During September, 1927, Will Rogers and his wife, Betty Rogers, purchased certain real property in the County of Los Angeles, State of California, described as follows: [15]

Lots 163 and 164, Tract 1719, as per Map recorded in Book 21, Pages 162 and 163 of Maps, in the office of the County Recorder of Los Angeles County, State of California.

The total purchase price of said property was $105,000.00 payable as follows: $15,000.00 in cash at the time of the purchase; the assumption of a note in the amount of $52,000.00, secured by a mortgage on said property and due and payable in 1930, and the giving of a promissory note for the balance of $38,000.00 to be secured by a Trust Deed on said property.

Will Rogers and his wife, Betty Rogers, paid said $15,000.00, assumed the payment of said $52,000.00 note, and executed and delivered to the seller their promissory note for $38,000.00 payable in 1932. In September, 1927, said property was conveyed to Will Rogers and his wife Betty Rogers and they conveyed said property to the Title Guarantee and Trust Company as trustee, as security for the payment of said $38,-000.00 note. Said property was acquired as community property of Will Rogers and his said wife. Said property was business property and the transaction was entered into for a profit.

(b) Prior to April 21, 1933 Will Rogers and his wife Betty Rogers paid in full said note for $52,000.00, which they had assumed. On April 21, 1933 said property was reconveyed by said trustee to Will Rogers and his wife Betty Rogers and they immediately conveyed said property to the [16] party from whom they had purchased it in 1927. The said note for $38,-000.00 was cancelled and Will Rogers and his wife Betty Rogers forfeited said property and all payments made toward the purchase thereof.

(c) Prior to April 21, 1933 Will Rogers and his wife, Betty Rogers paid $67,000.00 toward the purchase of said property and in addition thereto paid escrow expenses in the amount of $212.02, making a total of $67,212.02. For the years 1927 to 1932, inclusive, they claimed and were allowed depreciation on the improvements

on said property in the total amount of $13,-156.77. The total unrecovered cash investment in said property at the time of the forfeiture and reconveyance to the seller was $54,055.25. Will Rogers and his wife Betty Rogers each sustained a loss in 1933 from said transaction in the amount of to-wit, $27,027.63.

(d) Will Rogers and his wife Betty Rogers filed separate income tax returns for the calendar year 1933. In his income tax return for 1933 Will Rogers computed the loss on said transaction to be $57,643.46 and deducted one-half of said sum, of $28,821.73 as an ordinary loss in computing his net taxable income for said year. Respondent has disallowed the deduction of said loss as an ordinary loss and has determined that it was a capital loss and has treated it as a capital loss in recomputing the tax liability of Will Rogers for the year 1933. The deficiency herein in controversy results from respondent's determination that said loss was a capital loss. [17]

Wherefore, petitioners pray that the Board may hear and determine this appeal.

CLAUDE I. PARKER
JOHN B. MILLIKEN
BAYLEY KOHLMEIER
Attorneys for Petitioner,
808 Bank of America Bldg.,
Los Angeles, California.

BETTY ROGERS
JAMES K. BLAKE
OSCAR LAWLER
Executors of the estate of Will Rogers, dec'd, petitioners.

Of Counsel:
L. A. LUCE,
937 Munsey Bldg.,
Washington, D. C.

State of California
County of Los Angeles—ss.

James K. Blake, of the city of Beverly Hills, State of California, being first duly sworn, deposes and says; that he is one of the duly appointed, qualified and acting executors of the estate of Will Rogers, deceased, and is one of the petitioners in the foregoing petition; that he is familiar with the facts stated therein and the facts so stated are true and correct, except such facts as are stated upon information and belief and those facts he believes to be true.

JAMES K. BLAKE

Subscribed and sworn to before me this 25th day of May, 1936.

CATHERINE A. MACK
Notary Public in and for the County of Los Angeles, State of California. [18]

EXHIBIT A

Treasury Department
Washington

Mar. 4, 1936

Office of
Commissioner of Internal Revenue

Address reply to
Commissioner of Internal Revenue
And refer to

Mr. J. K. Blake, Co-Executor,
Estate of Will Rogers, Deceased,
c/o Mr. Claude I. Parker,
808 Bank of America Building,
Los Angeles, California.

Sir:

You are advised that the determination of the in-come tax liability of Will Rogers, Deceased, for the taxable year 1933, discloses a deficiency of $16,894.61, as shown in the statement attached.

In accordance with section 272(a) of the Revenue Act of 1932, as amended by section 501 of the Revenue Act of 1934, notice is hereby given of the deficiency mentioned within ninety days (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Commissioner of Internal Revenue, Wash-

ngton, D. C., for the attention of IT:C:P-7. The signing and filing of this form will expedite the closing of the return by permitting an early assessment of the deficiency and will prevent the accumulation of interest, since the interest period terminates thirty days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,

Commissioner.

By CHAS. T. RUSSELL

Deputy Commissioner.

Enclosures:

Statement

Form 870 [19]

STATEMENT

IT:AR:E-1

ML-90D

In re: Mr. J. K. Blake

Co-Executor, Estate of Will Rogers, Deceased,

c/o Mr. Claude I. Parker,

808 Bank of America Building,

Los Angeles, California.

Income Tax Liability

Year—1933

Income Tax Liability—$71,799.02

Income Tax Assessed—$54,904.41

Deficiency—$16,894.61

The deficiency shown herein is based upon the report dated November 19, 1935, prepared by Revenue

Agent P. Blackford, covering the income tax lia bility of Will Rogers, Deceased, a copy of whicl was transmitted to you.

Careful consideration has been accorded your pro test dated December 27, 1935, in connection witl findings of the examining officer, and the informa tion submitted at a conference held in the office o the internal revenue agent in charge.

The return has been adjusted as follows:

Net Income

Net income reported on the return		$144,350.72
Add:		
(1) Salary	$ 3,576.47	
(2) Reduction of business losses	2,867.69	
(3) Loss on disposition of property	28,821.73	
(4) Contributions	400.00	35,665.89
Ordinary net income adjusted		$180,016.61
Capital net loss reported	0	
(5) Capital net loss allowed		$ 27,027.63

Computation of Tax

Net income subject to surtax	$180,016.61
Less:	
Personal exemption and credit for dependents	2,900.00
Balance subject to normal tax	$177,116.61

[20

Normal tax at 4% on $4,000.00	$ 160.00
Normal tax at 8% on $173,116.61	13,849.33
Surtax on $180,016.61	61,168.14
Tax at 12½% on capital net loss of $27,027.63	(3,378.45
Corrected income tax liability	$ 71,799.02

ıcome tax assessed:

Account No. 809995	54,904.41
eficiency of tax	$ 16,894.61

Explanation of Changes

(1) In the deductions from gross salaries received the fol-ᐧwing items have been disallowed:

(a) The amount of $500.00 paid to Friar's Club for a certificate of indebtedness, representing an investment, has been disallowed:

(b) The travel expense deduction has been adjusted to eliminate the following:

Personal expenses charged on hotel bills	$ 961.08
Accident insurance while traveling in airplanes, a personal expense	3,075.50
Account #121, consisting of "cash" checks for personal use while not traveling	2,400.00
Total disallowed	$6,436.58

(c) The amount claimed as depreciation on a Cadillac automobile has been corrected to allow 50% for business use instead of 75%, resulting in a disallowance of 1/3 of $649.08, or $216.36.

Summary:

Amount paid for certificate of indebtedness	$ 500.00
Travel expenses	6,436.58
Depreciation	216.36
Total	$7,152.94
One-half applicable to husband's return	$3,576.47
One-half applicable to wife's return	$3,576.47

[21]

(2) Losses from business have been reduced as follows:

(a) Depreciation on Oklahoma ranches has been re- duced from $3,428.77 to $2,445.41, a difference of $983.36.

(b) The loss on Santa Monica ranch has been reduced by $4,752.03 as follows:

The deduction for maintenance of a tennis court has been disallowed as a personal expense	$ 215.45
One-half of compensation insurance has been disallowed as being personal	218.50
The insurance on the residence and furnishings is a personal expense	1,112.40
One-half of the foreman's salary is disallowed as a personal expense	1,500.00
Depreciation on livestock has been disallowed, because fully depreciated prior to 1933	720.00
One-half of the depreciation of $1,971.36 on trucks, tractor, and buildings has been disallowed as being personal	985.68
Total disallowed on Santa Monica Ranch	$4,752.03
Total disallowed on Oklahoma Ranches	983.36
Total disallowed on ranches	$5,735.39
One-half applicable to husband's return	$2,867.69
One-half applicable to wife's return	$2,867.70

(3) See (5) below.

(4) The following contributions have been disallowed as not deductible under the provisions of section 23(n) of the Revenue Act of 1932:

Ruby Adams Benefit	$ 200.00
Prescott Frontier Days	100.00
Fox Studio Employees	500.00
Total	$ 800.00
One-half applicable to husband's return	$ 400.00
One-half applicable to wife's return	$ 400.00

(5) and (3) The loss on the disposition of Bundy Bath House property has been adjusted to take into consideration the depreciation which was allowable in 1927 and 1928, and has been held to be a capital loss rather than an ordinary loss.

[22]

otal loss as claimed		$57,643.46
oss decreased on account of depreciation allowable:		
1927 (½ year)	$1,196.07	
1928	2,392.14	3,588.21
oss as corrected		$54,055.25
usband's loss		$27,027.63
'ife's loss		$27,027.62

It is held that the transaction whereby the de-
edent and his wife transferred all their right, title,
nd interest in the Bundy Bath House property to
'acific Palisades Corporation in 1933 in considera-
ion of the corporation's having cancelled and re-
urned to them the note for $38,000.00 which they
ave in part payment therefor in 1927, amounted to
n exchange of one asset for another asset, real es-
ate for the trust deed note. Accordingly, the loss on
he disposition is considered to be a capital loss fall-
ng under the provisions of section 101 of the Reve-
ue Act of 1932. Having acquired full title to the
roperty in 1927, the decedent and his wife upon
econveying the property to the Pacific Palisades
'orporation sustained a loss comparable to the loss
'hich they would have suffered if they had lost the
roperty through process of law. Such a case was
onsidered in General Counsel Memorandum 12737
Internal Revenue Cumulative Bulletin XIII-1,
20), and it was held that the resulting loss was a
apital loss.

Due to the fact that the expiration of the period
rovided in the statute of limitations will presently

bar any assessment of additional tax on the return filed for the year 1933, the Income Tax Unit will be unable to afford you an opportunity to protest this determination or to be accorded a hearing prior to the mailing of this statutory notice of deficiency.

Copies of this letter have been mailed to your representatives, Mr. George H. Koster, Bank of America Building, Los Angeles, California, and Mr. L. A. Luce, Munsey Building, Washington, D. C., in accordance with the authority conferred upon them in powers of attorney on file with the Bureau.

[Endorsed]: U.S.B.T.A. Filed May 29, 1936. [23]

[Title of Board and Cause—Docket No. 84896.]

ANSWER

Comes Now the Commissioner of Internal Revenue by his attorney, Herman Oliphant, General Counsel for the Department of the Treasury, and for answer to the above-styled petition admits and denies as follows:

1. Admits that petitioner James K. Blake is one of the duly appointed, qualified, and acting executors of the Estate of Will Rogers, Deceased. Admits that the decedent died testate on August 15, 1935. The respondent, having no information upon which to form a belief as to the remaining facts alleged in Paragraph 1, denies the same.

2 and 3. Denies the allegations contained in Paragraphs 2 and 3.

4(a), (b) and (c). Denies that the Commissioner rred as alleged in subparagraphs (a), (b) and (c) f Paragraph 4.

5(a) to (d), inclusive. Denies the allegations conained in subparagraphs (a) to (d), inclusive, of Paragraph 5.

Denies generally and specifically each and every llegation contained in the petition not hereinbefore dmitted, qualified, or denied. [24]

Wherefore, it is prayed that the appeal be denied.

(Signed) HERMAN OLIPHANT
General Counsel for the
Department of the Treasury.

Of Counsel:
B. H. NEBLETT,
HAROLD F. NONEMAN,
Special Attorneys,
Bureau of Internal Revenue.

[Endorsed]: U.S.B.T.A. Filed June 30, 1936. [25]

Title of Board and Cause.]

Docket Nos. 84895, 84896. Promulgated
May 18, 1938.

Decedent and wife purchased business property for which they paid cash, assumed a note secured by a mortgage upon the property, and executed and delivered a note secured by trust deed on the same property. The first note was

paid, but the second note was not paid when it became due in 1932. In 1933, pursuant to an agreement entered into with the holder of the second note, the property was conveyed to it and the note was surrendered and canceled. Held, the conveyance of the property by decedent and his wife in consideration for the cancellation of their debt was a "sale" within the meaning of that word as used in section 101 (c) (2) of the Revenue Act of 1932 and the loss sustained was a capital loss.

Claude I. Parker, Esq., John B. Milliken, Esq., Bayley Kohlmeier, Esq., and L. A. Luce, Esq., for the petitioners.

DeWitt M. Evans, Esq., for the respondent.

OPINION.

Mellott: These consolidated proceedings involve deficiencies in income taxes for the year 1933 in the amount of $17,055.90 in Docket No. 84895 and $16,-894.61 in Docket No. 84896. The respondent decreased a marital community loss, one-half of which was deducted by each member of the community as an ordinary loss, from $57,643.46 to $54,055.25, and treated it as a capital loss sustained equally by each member of the community. The only question involved is whether such loss is a capital loss or an ordinary loss.

The proceedings were submitted upon two stipulations of facts which, except for the purely formal

arts, are substantially the same. These stipulations re included herein by reference, a combined summary being sufficient for the pupose of the report. [26]

The petitioner, Betty Rogers, a resident of California, is the widow of Will Rogers, who died estate, a resident of California, on August 15, 1935. She, and the others shown in the caption in Docket No. 84896, were appointed executors of the estate of the decedent by the Superior Court of the State of California in and for the County of Los Angeles, on September 17, 1935.

During September 1927 the decedent and his wife purchased for profit certain business real estate situated in the county of Los Angeles, California, at a price of $105,000, payable as follows: $15,000 cash at the time of purchase, the assumption of a note in the amount of $52,000, which was secured by a mortgage on such property and became due and payable in 1930, and the giving of their promissory note for the balance of $38,000, secured by a trust deed on the property.

The decedent and his wife paid the $15,000 cash and prior to 1933 paid in full the $52,000 note.

The note for $38,000 and the beneficial interest under the deed of trust which secured it were transferred and assigned to the California Trust Co., a corporation. The note became due and payable on August 19, 1932.

On August 25, 1932, payment of the note and accrued interest thereon was demanded of decedent

and his wife and notice was given that, unless the principal and interest were paid, the holder of such note would proceed to enforce its rights under the provisions of the deed of trust given to secure payment of it.

Thereafter it was agreed by and between decedent and his wife and the holder of the $38,000 note and trust deed that the property be conveyed by the former to the latter and that the note be canceled and surrendered. Thereafter the property was reconveyed by the Title Guarantee & Trust Co. to the decedent and his wife and on April 21, 1933, they transferred and conveyed it to the California Trust Co., and the $38,000 note was surrendered to decedent and his wife and canceled.

In addition to the $67,000 paid by the decedent and his wife upon the purchase price of the property they also paid, prior to April 21, 1933, escrow expenses in the amount of $212.02, or a total of $67,212.02. For the years 1927 to 1932, inclusive, they were allowed depreciation on the improvements on the property in the total amount of $13,156.77. Their total unrecovered cash investment in such property at the time of its conveyance to the California Trust Co. was $54,055.25. The decedent and his wife each sustained a loss in 1933 from the transaction in the amount of $27,027.62.

The decedent and his wife filed separate returns for 1933. They computed a loss on the transaction in the amount of $57,643.46 and [27] each deducted one-half of that sum, or $28,821.73, as an ordinary

›ss, under the provisions of section 23 (e) of the ‹evenue Act of 1932. The respondent reduced the mount of the loss to $54,055.25, and, in recomputing ıe tax liability of each of them, treated the loss as capital loss within the meaning of section 101 of ıe Revenue Act of 1932. The deficiencies result rom respondent's determination that the loss was a ıpital loss.

The pertinent provisions of the Revenue Act of 932 are shown in the margin.[1]

Sec. 23. Deductions From Gross Income.

In computing net income there shall be allowed as eductions:

* * * * * *

(e) Losses by Individuals.—Subject to the limi- ıtions provided in subsection (r) of this section, in ıe case of an individual, losses sustained during the ıxable year and not compensated for by insurance r otherwise—

* * * * * *

(2) if incurred in any transaction entered into ɔr profit, though not connected with the trade or usiness. * * *

ec. 101. Capital Net Gains and Losses.

* * * * * *

(b) Tax in Case of Capital Net Loss.—In the ase of any taxpayer, other than a corporation, who ɔr any taxable year sustains a capital net loss (as ereinafter defined in this section), there shall be ›vied, collected, and paid, in lieu of all other taxes nposed by this title, a tax determined as follows: a artial tax shall first be computed upon the basis of ıe ordinary net income at the rates and in the ıanner as if this section had not been enacted, and ıe total tax shall be this amount minus 12½ per ›ntum of the capital net loss; but in no case shall ıe tax of a taxpayer who has sustained a capital

Petitioners argue that Rogers and his wife did not "have whole title to the property * * * but * * * merely an equity and a right to receive whole and complete title on completion of payment of the purchase price." That may be true; however, the property was deeded to them subject to the indebtedness which they assumed and paid, and it is stipulated that they claimed and were allowed depreciation on the improvements on it in the total amount of $13,156.77. The property was acquired in a transaction entered into for profit. It will be noted that " 'capital assets' means property held by the taxpayer for more than two years." Under the facts as stipulated, we think that the conclusion is inescapable that the real estate was "held" for more than two years within the purview of the statute.

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net loss be less than the tax computed without regard to the provisions of this section.

(c) Definitions.—for the purposes of this title—

* * * * * * *

(2) "Capital loss" means deductible loss resulting from the sale or exchange of capital assets.

* * * * * * *

(6) "Capital net loss" means the excess of the sum of the capital losses plus the capital deductions over the total amount of capital gain.

* * * * * * *

(8) "Capital assets" means property held by the taxpayer for more than two years (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale in the course of his trade or business. * * * [28]

Petitioners insist, however, that even though the roperty was a capital asset, the loss sustained upon s disposition was not a capital loss, as defined by ie statute, because it was neither sold nor exhanged. Having decided that the property was a apital asset, the only remaining question is whether was sold or exchanged.

On brief petitioners argue that when the entire ransaction was completed they were left with othing which they did not have prior to entering nto the contract or purchase and that they had sufered an actual loss in the amount of $54,055.25 $67,212.02 less $13,156.77); that in construing or nterpreting a statute the ordinary meaning of the vords used therein should be taken, citing Old Colony Railroad Co. v. Commissioner, 284 U. S. 552: ind that the transaction in question did not involve "sale or exchange" within the ordinary meaning of these words because they connote an acquisition of property by the bargaining parties through the exercise of a free will to buy and sell rather than he compromise of an outstanding indebtedness, the enforced collection of which had been threatened by neans of legal proceedings.

We agree with petitioners that in construing or interpreting a statute the ordinary meaning of the words used should be taken. "A sale, in the ordinary sense of the word is a transfer of property for a fixed price in money or its equivalent." Iowa v. McFarland, 110 U. S. 471, 478. "An exchange of property is a mutual transfer of one or more pieces

of property for property other than money." 23 C. J. 184. " 'The distinction between a sale and exchange of property is rather one of shadow than of substance. In both cases the title to property is absolutely transferred; and the same rules of law are applicable to the transaction, whether the consideration of the contract is money or by way of barter.' " Hale v. Helvering, 85 Fed.(2d) 819.

Prior to the transaction here involved petitioners had paid for the real estate $67,212.02 in cash, and had given their note for $38,000 to the vendor. This note had been transferred and assigned by the vendor to the California Trust Co. It is apparent, therefore, that the real property cost petitioners $105,212.02 and this amount (less depreciation allowed, $13,156.77) was their basis for gain or loss upon its sale or other disposition. We are not impressed with petitioners' argument that when they transferred the property to their creditor they merely paid their debt of $38,000, and that therefore there was no sale or exchange. We agree that they paid a debt; but the payment of a debt does not entitle a taxpayer to a loss deduction. Petitioners' claim for a deduction is based on the fact that they made a disposition of property and thereby sustained a loss. It can not be said that they received no consideration because then their loss [29] would have been $92,055.25 ($105,212.02 less $13,156.77) and not $54,055.25. By reason of the transfer of the property to their creditor petitioner were released from their promise to pay $38,000, and their credi-

or relinquished its right to collect this amount. In ur opinion the transaction should be treated either s a sale of petitioners' right, title, and interest in ie property for the price of their obligation or as n exchange of real estate for the obligation, both roperties having an equal value. We prefer to reard the transaction as a sale. This view is suported by a decision of the Supreme Judicial Court f Massachusetts in Gallus v. Elmer, 193 Mass. 106; 8 N. E. 772. In that case Gallus, who conducted a utcher and grocery business, sold certain fixtures, ools, utensils, and goods used in carrying on that usiness to one Kopec for $500, of which $100 was aid in cash, and the balance was to be paid on une 9, 1905. On June 9 Gallus demanded payment f the amount due, which was not paid. Kopec tated he was willing that Gallus should take all of he property in payment of the debt due, and an intrument was prepared reciting that Kopec, in conideration of $400 paid by Gallus, sold, transferred, nd delivered all of the property back to Gallus. 'he question arose whether the transfer of the proprty to Gallus in payment of the debt due constiuted a sale under the "Bulk Sales" act. In holding iat it did the court said:

> * * * While it is true that in its strictest sense a sale is a transfer of personal property in consideration of money paid or to be paid, still in the interpretation of statutes it is often held to include barter and any transfer of personal

> property for a valuable consideration. "In a general and popular sense, the sale of an article signifies the transfer of property from one person to another, for a consideration of value, without reference to the particular mode in which the consideration is paid." Bigelow, C. J., in Howard v. Harris, 8 Allen 297, 299.
> * * *

In support of their contention that the transaction was neither a sale nor an exchange petitioners rely upon Hale v. Helvering, supra; Commonwealth, Inc., 36 B. T. A. 850; and Dallas Transfer & Terminal Warehouse Co. v. Commissioner, 70 Fed. (2d) 95.

In Hale v. Helvering, supra, the taxpayers in 1925 sold an orange grove for the sum of $60,000. Title was transferred to the purchaser upon the payment of $20,000 in cash and the execution and delivery of $40,000 in notes secured by first mortgage. The taxpayers each reported their pro rata share of the profit upon this transaction in 1925, and paid the tax thereon. Upon maturity of the notes in 1927, the maker, although financially able to pay, refused to do so. A suit was instituted during the year 1929 to collect in the amount of $22,418.24, but prior to judgment, and during that year, a settlement was agreed to which resulted in a loss to the taxpayers of [30] $7,497.22. In holding that the loss was an ordinary loss the Court of Appeals for the District of Columbia said:

Accepting the definitions relied upon by the petitioner as constituting the ordinary meaning of the words in question, such definitions do not include the disposition of the notes under the facts here. There was no acquisition of property by the debtor, no transfer of property to him. Neither business men nor lawyers call the compromise of a note a sale to the maker. In point of law and in legal parlance property in the notes as capital assets was extinguished, not sold. In business parlance the transaction was a settlement and the notes were turned over to the maker, not sold to him. In John H. Watson, Jr., v. Commissioner of Internal Revenue, 27 B. T. A. 463, overruling Henry P. Werner v. Commissioner of Internal Revenue, 15 B. T. A. 482, it was held that the payment at maturity, of the face amount of bonds purchased at a premium, was not a sale or exchange resulting in a capital loss. If the full satisfaction of an obligation does not constitute a sale or exchange, neither does partial satisfaction. * * *

The court held, as this Board has held, "that the ompromise with the maker, who was able to pay hem, of promissory notes, for less than their face alue, does not constitute a sale or exchange of capial assets."

While we agree with the court that under the facts of the Hale case the compromise of a note was ot a "sale" or an "exchange", because the prop-

erty in the notes was extinguished, and not sold, we do not believe that this case is controlling of the instant proceedings. Petitioners disposed of real property. They are claiming the right to a loss deduction for the reason that the amount realized was less than the cost of the property to them. No compromise of a note is involved. Petitioners gave up all of their right, title, and interest in the real property for the equivalent of $38,000, and thereby reduced the amount of the loss resulting from their investment in the property by that amount. If petitioners had transferred the property for $38,000 in cash and then had used the cash to satisfy their indebtedness, it is clear that they would have made a sale of their property. We do not believe that the situation is changed where the property is transferred directly to the creditor in satisfaction of the indebtedness. Cf. United States v. Hendler, ... U. S. .... (Mar. 28, 1938); E. F. Simms, 28 B. T. A. 988, 1030. We do not construe the decision in the Hale case as meaning that the surrender of notes or cancellation of an indebtedness is not sufficient or proper consideration to support a sale. Many courts have held that the extinguishment of a preexisting debt may constitute a valuable consideration for a sale of property. Ferguson v. Larson (Cal.), 33 Pac. (2d) 1061; Bank of Centralia v. Chicago, Burlington & Quincy Railroad Co., 245 Ill. App. 211; David Bradley & Co. v. Kingman Implement Co., 79 Neb. 144; 112 N. W. 346; Rachman v. Clapp, 50 Neb. 648;

7 N. W. 259; Billings v. Warren, 21 Tex. Civ. App. 7; 50 S. W. 625. [31]

In Commonwealth, Inc., supra, also cited and relied upon by petitioners, the owner of realty, subject to a mortgage, deeded the property to the mortgagee without consideration and thereby sustained a loss. We held that the loss so sustained was an ordinary loss, and not a capital loss, and, among other things, said:

> * * * The purported release of liability under the mortgage was of no benefit to the petitioner, for it had no liability under the mortgage. Neither the petitioner nor its grantor assumed the mortgage liability, but took title, subject to it. Hence, there was no personal liability on the part of the petitioner. Hulin v. Veatch, 148 Or. 119; 35 Pac. (2d) 253; Metropolitan Bank v. St. Louis Dispatch Co., 149 U. S. 436; Fulton Gold Corporation, 31 B. T. A. 519. Inasmuch as there was in fact no consideration to the petitioner, the transfer of title was not a sale or exchange. The execution of the deed marked the close of a transaction whereby petitioner abandoned its title. Cf. A. J. Schwarzler Co., 3 B. T. A. 535, Greenleaf Textile Corporation, 26 B. T. A. 737, holding that a taxpayer does not sustain a deductible loss of the value of real estate while retaining title to it.

The instant proceedings are clearly distinguishable from Commonwealth, Inc., supra. In that case

the taxpayer received nothing in consideration of the transfer of the property to the mortgagee. Here, however, the taxpayers received a consideration of $10 and "in addition * * * full satisfaction of all obligations secured by the deed of trust [the $38,000 note]." The deed recites that "the consideration received by the grantors is equal to the fair value of grantors interest in said land."

The remaining case relied upon by the petitioners in Dallas Transfer & Terminal Warehouse Co. v. Commissioner, supra. There the taxpayer leased a warehouse for 20 years at a rental of $7,000 a month. By September 1928 the taxpayer owed its lessor $107,880.79 and was in an insolvent condition. It entered into an agreement with its lessor under the terms of which it conveyed to the latter certain property in which it had an equity of $17,507.20, and the lessor canceled the balance of the debt, charging it off as worthless. The Circuit Court of Appeals for the Fifth Circuit, in holding that the transaction did not constitute income to the taxpayer, said:

> * * * The transaction was not in form or substance a sale for $107,880.77 of property which had an appraised value of $17,507.20. In effect the transaction was similar to what occurs in an insolvency or bankruptcy proceeding when, upon a debtor surrendering, for the benefit of his creditors, property insufficient, in value to pay his debts, he is discharged from liability for his debts. This does not result in the debtor ac-

quiring something of exchangeable value in addition to what he had before. There is a reduction or extinguishment of liabilities without any increase of assets. There is an absence of such a gain or profit as is required to come within the accepted definition of income. * * * It hardly would be contended that a discharged insolvent or bankrupt receives taxable income in the amount by which his provable debts exceed the value of his surrendered assets. * * * Taxable income is not [32] acquired by a transaction which does not result in the taxpayer getting or having anything he did not have before. Gain or profit is essential to the existence of taxable income. A transaction whereby nothing of exchangeable value comes to or is received by a taxpayer does not give rise to or create taxable income. * * *

In our opinion there is nothing in the decision of ne court which is contrary to the conclusion we ave reached in the instant proceedings. We are onvinced that petitioners made a sale of a capital sset to their creditor. We therefore hold that the espondent's determination that the loss sustained vas a capital loss is correct.

Reviewed by the Board.

Judgment will be entered for the respondent. [33]

United States Board of Tax Appeals
Washington

Docket No. 84895.

BETTY ROGERS,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION.

Pursuant to the determination of the Board, as set forth in its report promulgated May 18, 1938, it is

Ordered and Decided: That there is a deficiency in income tax for the year 1933 in the amount of $17,055.90.

Entered May 19, 1938.

[Seal] (Signed) ARTHUR J. MELLOTT,
Member. [34]

United States Board of Tax Appeals
Washington

Docket No. 84896.

BETTY ROGERS, O. N. BEASLEY, OSCAR LAWLER, JAMES K. BLAKE, Executors of the Estate of Will Rogers, Deceased,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION.

Pursuant to the determination of the Board, as ›t forth in its report promulgated May 18, 1938, is

Ordered and Decided: That there is a deficiency ı income tax for the year 1933 in the amount of 16,894.61.

Entered May 19, 1938.

[Seal] (Signed) ARTHUR J. MELLOTT,
Member. [35]

Title of Board and Cause.]

Docket No. 84895

PETITION FOR REVIEW BY THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

'o the Honorable Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

Comes now Betty Rogers, by her attorneys, Claude I. Parker, John B. Milliken, Bayley Kohlneier, Harriet Geary and L. A. Luce and respectully shows:

I.

Jurisdiction

Betty Rogers, your petitioner, respectfully petiions this Honorable Court to review the decision of the United States Board of Tax Appeals entered on May 19, 1938, and finding a deficiency in income ax due from your petitioner for the calendar year 933 in the amount of $17,055.90.

Your petitioner at the time of filing this petitio is a citizen of the United States and resides in Lo Angeles County, State of California. [36]

The return of income tax in respect of whicl the aforementioned tax liability arose was filed b your petitioner with the Collector of Internal Rev enue for the Sixth Internal Revenue Collectio District of California, located in the City of Lo Angeles, State of California, which is located withi the jurisdiction of the Circuit Court of Appeal for the Ninth Judicial Circuit.

Jurisdiction in this Court to review the decisio of the United States Board of Tax Appeals afore said is founded on Sections 1001-3 of the Revenu Act of 1926 as amended by Sections 603 of the Rev enue Act of 1928, 1101 of the Revenue Act of 193 and 1519 of the Revenue Act of 1934.

The Commissioner determined a deficiency in pe titioner's income taxes for the calendar year 193 in the amount of $17,055.90 and on March 4, 193 in accordance with the provisions of Section 274 o the Revenue Act of 1926, sent to petitioner by regis tered mail a notice of said deficiency. Thereafte petitioner filed an appeal from said determinatio of deficiency with the United States Board of Ta Appeals.

Said appeal was called for hearing by the Boar of Tax Appeals on September 27, 1937 at Los A geles, California. At said hearing upon motion o counsel, it was ordered that said appeal be consoli dated for hearing and decision with the appeal o Betty Rogers, O. N. Beasley, Oscar Lawler, Jame K. Blake, Executors of the Estate of Will Rogers

ceased, for the same year and involving identical ssues of fact and law, Docket No. 84896. On May 8, 1938 the Board promulgated its opinion in which he [37] stipulation of facts of the parties conining the only facts presented in the proceeding vas incorporated by reference and on May 19, 1938, he Board of Tax Appeals entered its decision, as foresaid.

II.

Nature of Controversy.

The deficiency for the year 1933, which was in ontroversy before the Board of Tax Appeals, arose nd resulted from the determination of the Comnissioner that the loss of $27,027.62 sustained by etitioner in that year constituted a capital loss for ncome tax purposes as distinguished from an ordiary loss as claimed and maintained by petitioner.

During September 1927, petitioner and her husand Will Rogers, now deceased, purchased from Oren B. Waite certain real property in the County f Los Angeles, State of California, for a total purhase price of $105,000.00 payable as follows: 15,000.00 cash at time of purchase, assumption of note in the amount of $52,000.00 secured by a nortgage on the property and the giving of a promssory note for the balance of $38,000.00 secured by trust deed on the property. The $15,000.00 cash vas paid, the payment of the note was assumed and etitioner and her husband executed and delivered o the seller their note in the amount of $38,000.00, ayable on or before August 19, 1932 with interest

at seven per cent per annum. The property was conveyed to petitioner and her husband subject to the mortgage and immediately thereafter they conveyed it to Title Guarantee and Trust Company, a corporation, as trustee, to secure payment of the $38,000.00 note. [38]

This property was acquired by petitioner and her husband as community property. It was business property and the transaction was one entered into for profit.

Before 1933 petitioner and her husband paid the $52,000.00 note which had been assumed by them in full. Also, before 1933, the $38,000.00 note payable to Oren B. Waite, the seller, and the beneficial interest under the trust deed were duly transferred and assigned to California Trust Company, a corporation. On August 19, 1932 the note became due and payable. It was not paid on the due date and on August 25, 1932, payment was demanded of petitioner and her husband and notice was given that unless the same was paid, the holder thereof would proceed to enforce its rights under the deed of trust.

Threafter it was agreed by petitioner and her husband and the holder of said $38,000.00 note that cancellation of said note could be accomplished by conveyance of the property by which it was secured to the holder of the note. Thereafter, in the year 1933, this was done and the note was surrendered to petitioner and her husband and cancelled. Thus, prior to April 21, 1933, petitioner and her husband paid $67,000.00 toward the purchase price of the property, and in addition thereto, paid escrow

xpenses in the amount of $212.02, or a total of 67,212.02. For the years 1927 to 1932, inclusive, etitioner and her husband claimed and were al- owed depreciation on the improvements on said roperty in the total amount of $13,156.77. The otal loss in cash investment was therefore $54,- 55.25 and petitioner by reason of the community roperty character of the property sus- [39] tained ne-half of said total loss or the sum of $27,027.62.

The Commissioner determined that the loss on his transaction constituted a capital rather than n ordinary loss to petitioner for the year 1933 and lisallowed the ordinary loss claimed by petitioner n her return and treated the loss in the amount foresaid as a capital loss.

The Board of Tax Appeals sustained the Com- nissioner's aforesaid determination and affirmed he deficiency resulting therefrom.

III.

Assignment of Error.

In making its decision as aforesaid, the United States Board of Tax Appeals committed the fol- owing errors on which your petitioner relies as the basis of this proceeding:

1. The United States Board of Tax Appeals erred in ordering a deficiency in petitioner's income tax for the calendar year 1933 in the amount of $17,055.90.

2. The United States Board of Tax Appeals erred in deciding that the loss sustained by

petitioner in the year 1933 on reconveyance of the property in question in payment and cancellation of her and her husband's liability on their outstanding note leaving unrecovered a cash investment in the property in the amount of $27,027.62 was a capital loss for income tax purposes for the reason that as a matter of law the loss occurring under such circumstances constituted an ordinary loss under the applicable Revenue Act. [40]

3. The United States Board of Tax Appeals erred in holding that the loss sustained by a purchaser of real property upon reconveyance of said property to cancel the balance due on the purchase money note and forfeiture of prior cash payments, constituted a capital rather than an ordinary loss under the Revenue Act of 1932.

4. The United States Board of Tax Appeals erred as a matter of law in deciding that the reconveyance of purchased premises, subject to a trust deed given to secure the payment of a purchase money note, in cancellation of the indebtedness thereon, constituted a sale of a capital asset, the loss suffered from the sale of which was a capital loss.

5. The United States Board of Tax Appeals erred in ordering that petitioner was not entitled to deduct for income tax purposes an ordinary loss in the amount of $27,027.62 in the calendar year 1933 by reason of the reconveyance of certain property, which she had pur-

chased and which was subject to a trust deed to secure the payment of the remainder of the purchase price, and forfeiture of the cash purchase price theretofore paid thereon, for the reason that such order of the United States Board of Tax Appeals is contrary to the facts stipulated by the parties to this proceeding and the law applicable thereto.

Wherefore your petitioner prays that this Honrable Court may review the decision and order of he United States Board of Tax Appeals and set side the same and direct the entry [41] of a deciion by said Board determining that there is no eficiency in income tax for the year 1933, greater han $5,028.61, which amount is conceded by petiioner herein, due from the petitioner, and for such ther and further relief as may to this Court seem roper in the premises.

CLAUDE I. PARKER
JOHN B. MILLIKEN
BAYLEY KOHLMEIER
HARRIET GEARY
L. A. LUCE
Attorneys for Petitioner.

State of California
'ounty of Los Angeles.—ss.

Harriet Geary being first duly sworn says: I am one of the attorneys for the petitioner in this proeeding. I prepared the foregoing petition and am

familiar with the contents thereof. The allegation of fact contained therein are true to the best o my knowledge, information and belief. This peti tion is not filed for the purpose of delay and I be lieve the petitioner is justly entitled to the relie sought.

HARRIET GEARY

Subscribed and sworn to before me this 5th day of August, 1938.

PEARL ANDERSON
Notary Public in and for the County of Los Angeles, State of California.

[Endorsed]: U.S.B.T.A. Filed Aug. 13, 1938

[42]

[Title of Board and Cause—No. 84895.]

To: Hon. Guy T. Helvering,
Commissioner of Internal Revenue,
Internal Revenue Building,
Washington, D. C.

Hon. J. P. Wenchel, Attorney for Respondent,
Chief Counsel,
Bureau of Internal Revenue,
Internal Revenue Building,
Washington, D. C.

You Are Hereby Notified that on the 13th day of August, 1938, a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit of the decision of the United States Board of

[T]ax Appeals heretofore rendered in the above en-[t]itled cause, was filed with the Clerk of the Board. [A] copy of the petition as filed is attached hereto and [s]erved upon you.

Dated:

CLAUDE I. PARKER
JOHN B. MILLIKEN
BAYLEY KOHLMEIER
HARRIET GEARY
Attorney for Petitioner
808 Bank of America Bldg.
Los Angeles, California.

Of Counsel:
L. A. LUCE
937 Munsey Bldg.,
Washington, D. C. [43]

Service of the foregoing notice of filing and of a [c]opy of the petition for review is hereby acknowl-[e]dged this 13th day of August, 1938.

J. P. WENCHEL
Chief Counsel for the
Bureau of Internal Revenue,
Attorney for Respondent.

[Endorsed]: U.S.B.T.A. Filed Aug. 13, 1938. [44]

[Title of Board and Cause—Docket No. 84896.]

PETITION FOR REVIEW BY THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

To the Honorable Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

Come now Betty Rogers, O. N. Beasley, Oscar Lawler, James K. Blake, Executors of the Estate of Will Rogers, deceased, by their attorneys, Claude I. Parker, John B. Milliken, Bayley Kohlmeier, Harriet Geary and L. A. Luce, and respectfully show:

I.

Jurisdiction

Betty Rogers, O. N. Beasley, Oscar Lawler, James K. Blake, Executors of the Estate of Will Rogers, deceased, your petitioners, respectfully petition this Honorable Court to review the decision of the United States Board of Tax Appeals entered on May 19, 1938, and finding a deficiency in income tax due from the estate of Will Rogers, deceased for the calendar year 1933 in the amount of $16,894.91. [45]

Your petitioners at the time of filing this petition are citizens of the United States and reside in Los Angeles County, State of California.

The return of income tax in respect of which the aforementioned tax liability arose was filed by Will Rogers, now deceased, with the Collector of Internal Revenue for the Sixth Internal Revenue Collection

District of California, located in the City of Los Angeles, State of California, which is located within the jurisdiction of the Circuit Court of Appeals for the Ninth Judicial Circuit.

Jurisdiction in this Court to review the decision of the United States Board of Tax Appeals aforesaid, is founded on Sections 1001-3 of the Revenue Act of 1926 as amended by Sections 603 of the Revenue Act of 1928, 1101 of the Revenue Act of 1932 and 1519 of the Revenue Act of 1934.

The Commissioner determined a deficiency in petitioner's income taxes for the calendar year 1933 in the amount of $16,894.91 and on March 4, 1936 in accordance with the provisions of Section 274 of the Revenue Act of 1926, sent to petitioners by registered mail a notice of said deficiency. Thereafter petitioners filed an appeal from said determination of deficiency with the United States Board of Tax Appeals.

Said appeal was called for hearing by the Board of Tax Appeals on September 27, 1937 at Los Angeles, California. At said hearing upon motion of counsel, it was ordered that said appeal be consolidated for hearing and decision with the appeal of Betty Rogers for the same year and involving identical issues of fact and law, Docket No. 84895. On May 18, 1938 the [46] Board promulgated its opinion in which the stipulation of facts of the parties containing the only facts presented in the proceeding was incorporated by reference and on

May 19, 1938, the Board of Tax Appeals entered its decision, as aforesaid.

II.

Nature of Controversy.

The deficiency for the year 1933, which was in controversy before the Board of Tax Appeals, arose and resulted from the determination of the Commissioner that the loss of $27,027.63 sustained by Will Rogers in that year constituted a capital loss for income tax purposes as distinguished from an ordinary loss as claimed by Will Rogers and maintained by petitioners.

During September 1927, Will Rogers and his wife, Betty Rogers, purchased from Oren B. Waite certain real property in the County of Los Angeles, State of California, for a total purchase price of $105,000.00 payable as follows: $15,000.00 cash at time of purchase, assumption of a note in the amount of $52,000.00 secured by a mortgage on the property and the giving of a promissory note for the balance of $38,000.00 secured by a trust deed on the property. The $15,000.00 cash was paid, the payment of the note was assumed and Mr. and Mrs. Rogers executed and delivered to the seller their note in the amount of $38,000.00, payable on or before August 19, 1932, with interest at seven per cent per annum. The property was conveyed to Mr. and Mrs. Rogers subject to the mortgage and immediately thereafter they conveyed it to Title Guarantee and Trust Company, a corporation, as trustee,

o [47] secure payment of the $38,000.00 note.

This property was acquired by Mr. and Mrs. Rogers as community property. It was business property and the transaction was one entered into for profit.

Before 1933 Mr. and Mrs. Rogers paid the $52,000.00 note which had been assumed by them in full. Also before 1933, the $38,000.00 note payable to Oren B. Waite, the seller, and the beneficial interest under the trust deed were duly transferred and assigned to California Trust Company, a corporation. On August 19, 1932 the note became due and payable. It was not paid on the due date and on August 25, 1932, payment was demanded of Mr. and Mrs. Rogers and notice was given that unless the same was paid, the holder thereof would proceed to enforce its rights under the deed of trust.

Thereafter it was agreed by Mr. and Mrs. Rogers and the holder of said $38,000.00 note that cancellation of said note could be accomplished by conveyance of the property by which it was secured to the holder of the note. Thereafter in the year 1933 this was done and the note was surrendered to Mr. and Mrs. Rogers and cancelled. Thus prior to April 1 ,1933 Mr. and Mrs. Rogers paid $67,000.00 toward the purchase price of the property, and in addition thereto, paid escrow expenses in the amount of 212.02 or a total of $67,212.02. For the years 1927 to 1932 inclusive, Mr. and Mrs. Rogers claimed and were allowed depreciation on the improvements on said property in the total amount of $13,156.77. The

total loss in cash investment was therefore $54,-055.25 and by reason of the community property character of [48] the property Will Rogers sustained one-half of said total loss or the sum of $27,027.62.

The Commissioner determined that the loss on this transaction constituted a capital rather than an ordinary loss to Mr. Rogers for the year 1933 and disallowed the ordinary loss claimed by him on his return and treated the loss in the amount aforesaid as a capital loss.

The Board of Tax Appeals sustained the Commissioner's aforesaid determination and affirmed the deficiency resulting therefrom.

III.

Assignment of Error.

In making its decision as aforesaid, the United States Board of Tax Appeals committed the following errors on which your petitioners rely as the basis of this proceeding:

1. The United States Board of Tax Appeals erred in ordering a deficiency income tax of Will Rogers, deceased, for the calendar year 1933 in the amount of $16,894.61.

2. The United States Board of Tax Appeals erred in deciding that the loss sustained by Will Rogers, deceased, in the year 1933 on reconveyance of the property in question in payment and cancellation of his and his wife's liability

on their outstanding note leaving unrecovered a cash investment in the property in the amount of $27,027.63, was a [49] capital loss for income tax purposes for the reason that as a matter of law the loss occurring under such circumstances constituted an ordinary loss under the applicable Revenue Act.

3. The United States Board of Tax Appeals erred in holding that the loss sustained by a purchaser of real property upon reconveyance of said property to cancel the balance due on the purchase money note and forfeiture of prior cash payments constituted a capital rather than an ordinary loss under the Revenue Act of 1932.

4. The United States Board of Tax Appeals erred as a matter of law in deciding that the reconveyance of purchased premises subject to a trust deed given to secure the payment of a purchase money note, in cancellation of the indebtedness thereon constituted a sale of a capital asset, the loss suffered from the sale of which was a capital loss.

5. The United States Board of Tax Appeals erred in ordering that Will Rogers was not entitled to deduct for income tax purposes an ordinary loss in the amount of $27,027.63 in the calendar year 1933 by reason of the reconveyance of certain property which he had purchased and which was subject to a trust deed to secure the payment of the remainder of the purchase price and forfeiture of the cash pur-

chase price theretofore paid thereon, for the reason [50] that such order of the United States Board of Tax Appeals is contrary to the facts stipulated by the parties to this proceeding and the law applicable thereto.

Wherefore your petitioners pray that this Honorable Court may review the decision and order of the United States Board of Tax Appeals and set aside the same and direct the entry of a decision by said Board determining that there is no deficiency in income tax due from petitioners, as executors of the estate of Will Rogers, deceased, greater than $4,867.31, which amount is conceded by petitioners, and for such other and further relief as may to this Court seem proper in the premises.

CLAUDE I. PARKER
JOHN B. MILLIKEN
BAYLEY KOHLMEIER
HARRIET GEARY
L. A. LUCE
Attorneys for Petitioners.

State of California
County of Los Angeles—ss.

Harriet Geary being first duly sworn says; I am one of the attorneys for the petitioners in this proceeding. I prepared the foregoing petition and am familiar with the contents thereof. The allegations of fact contained therein are true to the best of my knowledge, information and belief. This petition is not filed [51] for the purpose of delay and I be-

lieve the petitioners are justly entitled to the relief sought.

HARRIET GEARY

Subscribed and sworn to before me this 5th day of August, 1938.

PEARL ANDERSON

Notary Public in and for the County of Los Angeles, State of California.

[Endorsed]: U. S. B. T. A. Filed Aug. 13, 1938. [52]

[Title of Board and Cause—Docket No. 84896.]

To: Hon. Guy T. Helvering,
Commissioner of Internal Revenue,
Internal Revenue Building,
Washington, D. C.

Hon. J. P. Wenchel, Attorney for Respondent,
Chief Counsel,
Bureau of Internal Revenue,
Internal Revenue Building,
Washington, D. C.

You are hereby notified that on the 13th day of August, 1938, a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit of the decision of the United States Board of Tax Appeals heretofore rendered in the above entitled cause, was filed with the Clerk of the

Board. A copy of the petition as filed is attached hereto and served upon you.

Dated:

CLAUDE I. PARKER
JOHN B. MILLIKEN
BAYLEY KOHLMEIER
HARRIET GEARY
Attorneys for Petitioners.
808 Bank of America Bldg.,
Los Angeles, California.

Of Counsel:
L. A. LUCE
937 Munsey Bldg.,
Washington, D. C. [53]

Service of the foregoing notice of filing and of a copy of the petition for review is hereby acknowledged this 13th day of August, 1938.

J. P. WENCHEL
Chief Counsel for the Bureau of Internal Revenue
Attorney for Respondent.

[Endorsed]: U. S. B. T. A. Filed Aug. 13, 1938. [54]

[Title of Board and Cause—Docket Nos. 84895 and 84896.]

STATEMENT OF EVIDENCE.

The above entitled cases came on for hearing at Los Angeles, California, before the Hon. Arthur J.

Mellott, Member of the United States Board of Tax Appeals on the 27th day of December, 1937, Claude I. Parker, John B. Milliken and Bayley Kohlmeier, Esqs., appearing on behalf of petitioners and J. P. Wenchel, Esq., appearing on behalf of the respondent.

At the time of said hearing, said above mentioned cases were consolidated for the purpose of hearing and argument pursuant to the order of said Hon. Arthur J. Mellott, Member, presiding. [55]

Thereupon the petitioners, to maintain the issues in their behalf, introduced in evidence Stipulations of Facts together with certain exhibits attached to said Stipulations, the same being all of the facts and evidence introduced at said hearing. For the reason that each of said Stipulations covers and relates to identical facts with the exception of certain formal facts having to do with the death of the taxpayer, Will Rogers, and the appointment of petitioners Betty Rogers, O. N. Beasley, Oscar Lawler and James K. Blake, as executors of his estate, and for the reason that the exhibits referred to and attached to the separate Stipulations are identical, the Stipulation of Facts in the case of Betty Rogers, O. N. Beasley, Oscar Lawler and James K. Blake, Executors of the Estate of Will Rogers, deceased, vs. Commissioner of Internal Revenue, Docket No. 84896, will be set out in full in this statement of evidence together with the exhibits attached thereto and only those paragraphs in the Stipulation filed in the case of Betty Rogers v.

Commissioner of Internal Revenue, Docket No. 84895 in which there are any facts substantially new or different from those presented in the Stipulation in Docket No. 84896 will be included in this statement of evidence in order that the record may not be encumbered by the repetitious matter:

[56]

[Title of Board and Cause—Docket No. 84896.]

STIPULATION OF FACTS.

It is hereby stipulated and agreed by and between the parties hereto, through their respective counsel of record, that the following are true and material facts involved in this cause and may be found as facts by the Board of Tax Appeals.

I.

Petitioners are individuals residing in the County of Los Angeles, State of California, and are the duly appointed, qualified and acting Executors of the Estate of Will Rogers, deceased. Decedent, a resident of the City of Beverly Hills, California, died testate on August 15, 1935. On September 17, 1935, petitioners were duly appointed executors of the estate of Will Rogers, deceased, by the Superior Court of the State of California, in and for the County of Los Angeles.

II.

The notice of deficiency herein was mailed on March 4, 1936. A true copy of said notice of de-

ciency is attached to the petition herein and narked Exhibit A.

III.

The taxes in controversy are income taxes of Will Rogers, deceased, for the calendar year 1933 in the mount of $16,894.61.

IV.

During September, 1927, Will Rogers and his vife, Betty Rogers, purchased from Oren B. Waite ertain real property in the County of Los Angeles, State of California, described as follows: Lots 163 und 164, Tract 1719, as per map recorded in Book 21, pages 162 and 163 of Maps in the Office of the County Recorder of Los Angeles County, State of California. The total purchase price of [57] said property was $105,000.00, payable as follows: $15,-000.00 cash at the time of the purchase, the assumption of a note in the amount of $52,000.00, which note was secured by a mortgage on said property and became due and payable in 1930, and the giving of a promissory note for the balance of $38,000.00 o be secured by a trust deed on said property.

In September, 1927, Will Rogers and Betty Rogers paid said $15,000.00 cash and assumed the payment of said note for $52,000.00, which was ecured by a mortgage on said property. Also in September, 1927, Will Rogers and Betty Rogers nade, executed and delivered to the seller, Oren B. Waite, their promissory note in the amount of $38,-000.00, which note was made payable to Oren B.

Waite, or his order, was dated August 19, 1927, provided for the payment of interest at the rate of seven per cent per annum and was payable on or before August 19, 1932.

The above described property which was purchased by Will Rogers and Betty Rogers, as aforesaid, was conveyed to Will Rogers and Betty Rogers subject to said mortgage for $52,000.00 and immediately thereafter Will Rogers and Betty Rogers conveyed the said property to the Title Guarantee and Trust Company, a corporation, as Trustee, to be held in trust as security for the payment of said promissory note in the amount of $38,000.00 given by Will Rogers and Betty Rogers to said Oren B. Waite. A true copy of said deed of trust is attached hereto, marked Exhibit A, and hereby made a part hereof.

V.

Said property was acquried by Will Rogers and his wife, Betty Rogers, as community property. Said property was business property and the acquisition thereof by Will Rogers and his wife, [58] Betty Rogers, was a transaction entered into for profit.

VI.

Prior to 1933 Will Rogers and Betty Rogers paid in full said note in the amount of $52,000.00 which had been assumed by Will Rogers and Betty

ogers at the time of the purchase of said prop-
ty.

VII.

Prior to 1933 said note of Will Rogers and Betty
ogers, in the amount of $38,000.00, payable to
ren B. Waite, and the beneficial interest under
he deed of trust which secured said note, were duly
ransferred and assigned to the California Trust
ompany, a corporation.

On August 19, 1932, said note in the amount of
38,000.00 became due and payable. Said note was
ot paid on the due date but was surrendered and
ancelled in the manner described below. On August
5, 1932 payment of said note in the amount of
38,000.00 and accrued interest thereon was de-
anded of Will Rogers and Betty Rogers, and
otice was given that unless said principal and
nterest were paid, the holder of said note would
roceed to enforce its rights under the provisions
f the deed of trust given to secure payment of said
ndebtedness.

Thereafter it was agreed by and between Will
Rogers and Betty Rogers and the holder of said
38,000.00 note and the trust deed securing said note
hat said property be conveyed by Will Rogers and
Betty Rogers to the holder of said note and that
aid note be cancelled and surrendered.

Thereafter said property was re-conveyed by
Title Guarantee and Trust Company, the trustee

in the said deed of trust attached hereto as Exhibit A, to Will Rogers and Betty Rogers [59] and on April 21, 1933 Will Rogers and Betty Rogers transferred and conveyed said property to the California Trust Company, a corporation, and said note in the amount of $38,000.00 was surrendered to Will Rogers and Betty Rogers and cancelled. A true copy of said deed of Will Rogers and Betty Rogers to the California Trust Company is attached hereto, marked Exhibit B, and hereby made a part hereof.

VIII.

Prior to April 21, 1933 Will Rogers and Betty Rogers paid $67,000.00 toward the purchase price of said property and, in addition thereto, paid escrow expenses in the amount of $212.02, or a total of $67,212.02.

For the years 1927 to 1932 inclusive Will Rogers and Betty Rogers claimed and were allowed depreciation on the improvements on said property in the total amount of $13,156.77. The total unrecovered cash investment in said property of Will Rogers and Betty Rogers at the time of the conveyance of said property to the California Trust Company on April 21, 1933, as aforesaid, was $54,055.25. Will Rogers and Betty Rogers each sustained a loss in the year 1933 from said transaction in the amount of $27,027.62.

IX.

Will Rogers and his wife, Betty Rogers, filed separate income tax returns for the year 1933. Will

Rogers duly filed his income tax return for the year 1933 with the Collector of Internal Revenue for the Sixth District of California, at Los Angeles, California. In his said income tax return for the year 1933 [60] Will Rogers computed a loss on said transaction in the amount of $57,643.46 and deducted one-half of said sum, or, to-wit, $28,821.73, as an ordinary loss under the provisions of Section 23(e) of the Revenue Act of 1932, in computing his net taxable income for said year. Respondent reduced the amount of said loss to $54,055.25 and further determined that said loss was a capital loss within the meaning of Section 101 of the Revenue Act of 1932 and treated said loss as a capital loss in recomputing the tax liability of Will Rogers for the year 1933. The deficiency herein in controversy results from respondent's determination that said loss was a capital loss.

Respectfully submitted,

CLAUDE I. PARKER
JOHN B. MILLIKEN
BAYLEY KOHLMEIER
Counsel for Petitioner.

J. P. WENCHEL
Counsel for Respondent.

EXHIBIT A.

DEED OF TRUST.

This Deed of Trust, made this 19th day of Augus 1927 between Will Rogers and Betty Rogers, h wife, herein called Trustor,

Title Guarantee and Trust Company

a Corporation, of Los Angeles, California, herei called Trustee, and

Oren B. Waite

herein called Beneficiary, [61]

Witnesseth: That Trustor hereby Grants t Trustee, in Trust, With Power of Sale, all tha property in the County of Los Angeles, State o California, described as:

> Lots One Hundred Sixty-three (163) anc One Hundred Sixty-four (164) of Tract Num ber Seventeen Hundred Nineteen, in the County of Los Angeles, State of California, as per map recorded in Book 21 pages 162 and 163 of Maps in the office of the County Recorder of saic County.
>
> Subject to a mortgage of $52,000.00 of date August 19, 1927.

For the Purpose of Securing:

First. Payment of the indebtedness evidenced by one promissory note (and any renewal or extension thereof) substantially in form as follows:

38,000.00 Los Angeles, California, August 19, 1927.
n or before five (5) years after date, for value
eceived, We promise to pay to Oren B. Waite, or
rder, at Los Angeles, California, the sum of Thirty-
ght thousand 00/100 Dollars, with interest from
ate until paid, at the rate of seven per cent per
nnum, payable semi-annually.

Should interest not be so paid it shall become part
f the principal and thereafter bear like interest.
hould default be made in payment of interest when
ue, the whole sum of principal and interest shall,
the option of the holder of this note, become im-
ediately due. Principal and interest payable in
nited States gold coin. This note is secured by a
eed of Trust to Title Guarantee and Trust Com-
ompany, a corporation, of Los Angeles, California.

(Signed) WILL ROGERS
(Signed) BETTY ROGERS

This note and deed of trust are given for part
urchase price of the premises mentioned.

Second. Payment and/or performance of every
oligation, covenant, promise or agreement herein
ontained.

To have and to hold said property upon the fol-
wing express trusts, to-wit:

A. Trustor promises and agrees, during contin-
ance of these Trusts:

1. For the purpose of protecting and preserving
he security of this Deed of Trust: (a) to properly
are for and keep said property in good condition

and repair; (b) not to remove or demolish an building thereon; (c) to complete in a good an workmanlike manner any building which may b constructed thereon, and to pay when due all claim for labor performed and materials furnished there for; (d) to comply with all laws, ordinances an regulations requiring any alterations or improve ments to be made thereon; (e) not to commit o permit any waste or deterioration thereof; (f) no to commit, suffer or permit any act to be done i or upon said property in violation of any law o ordinance; (g) to cultivate, irrigate, fertilize, fumi gate, prune and/or do any other act or acts, all i a timely and proper manner, which, from the char acter or use of said property, may be reasonabl necessary to protect and [62] preserve said security the specific enumerations herein not excluding th general.

2. To provide, maintain and deliver to Benefic iary fire insurance satisfactory to and with loss pay able to beneficiary. The amount collected under an fire insurance policy shall be credited first, t accrued interest; next, to expenditures hereunde and any remainder upon the principal, and interes shall thereupon cease upon the amount so credite upon principal; provided, however, that at optio of Beneficiary, the entire amount so collected or an part thereof may be released to Trustor, withou liability upon Trustee for such release.

3. To appear in and defend any action or pro ceeding purporting to affect the security of this

Deed of Trust, the interests of Beneficiary or the rights, powers and duties of Trustee hereunder; and to pay all costs and expenses, including cost of evidence of title and attorney's fees in a reasonable sum, in any such action or proceeding in which Beneficiary and/or Trustee may appear.

4. To pay before default or delinquency: (a) all taxes, assessments or incumbrances (including any debt secured by Deed of Trust), which appear to be prior liens or charges upon said property or any part thereof, including assessments on appurtenant water stock, and any accrued interest, cost or penalty thereon; (b) all costs, fees and expenses of these Trusts, including cost of evidence of title and Trustee's fees in connection with sale, whether completed or not, which amounts shall become due upon delivery to Trustee of Declaration of Default and Demand for Sale, as hereinafter provided.

5. To pay within thirty days after expenditure, without demand, all sums expended by Trustee or Beneficiary under the terms hereof, with interest from date of expednitui'e at the rate of ten per cent per annum.

B. Should Trustor fail or refuse to make any payment or to do any act, which he is obligated hereunder to make or do, at the time and in the manner herein provided, then Trustee and/or Beneficiary, each in his sole discretion, may, without notice to or demand upon Trustor and without releasing Trustor from any obligation hereof;

1. Make or do the same in such manner and to such extent as may be deemed necessary to protect the security of this Deed of Trust, either Trustee or Beneficiary being authorized to enter upon and take possession of said property for such purposes.

2. Commence, appear in or defend any action or proceeding affecting or purporting to affect the security of this Deed of Trust, the interests of Beneficiary or the rights, powers and duties of Trustee hereunder, whether brought by or against Trustor, Trustee or Beneficiary; or

3. Pay, purchase, contest or compromise any prior claim, debt, lien, charge or incumbrance which in the judgment of either may affect or appear to affect the security of this Deed of Trust, the interests of Beneficiary or the rights, powers and duties of Trustee hereunder.

Provided that neither Trustee nor Beneficiary shall be under any obligation to make any of the payments or do any of the acts above mentioned but, upon election of either or both so to do, employment of an attorney is authorized and payment of such attorney's fees is hereby secured.

C. Trustee shall be under no obligation to notify any party hereto of any action or proceeding of any kind in which Trustor, Beneficiary and/or Trustee shall be named as defendant, unless brought by Trustee.

D. Acceptance by Beneficiary of any sum in payment of any indebtedness secured hereby, after the date when the same is due, shall not constitute [63] a waiver of the right either to require prompt

ayment, when due, of all other sums so secured or o declare default as herein provided for failure so o pay.

E. Trustee may, at any time, or from time to ime, without liability therefor and without notice, upon written request of Beneficiary and presenta- ion of this Deed of Trust and the note secured hereby for endorsement, and without affecting the personal liability of any person for payment of the ndebtedness secured hereby or the effect of this Deed of Trust upon the remainder of said property:

1. Reconvey any part of said property;

2. Consent in writing to the making of any map or plat thereof; or

3. Join in granting any easement thereon.

F. Upon payment of all sums secured hereby and surrender to Trustee, for cancellation, of this Deed of Trust and the note secured hereby, Trustee, upon receipt from Beneficiary of a written request reciting the fact of such payment and surrender, shall reconvey, without warranty, the estate then held by Trustee, and the Grantee in such reconvey- ance may be described in general terms as "the per- son or persons legally entitled thereto", and Trustee is authorized to retain this Deed of Trust and such note. The recitals in such reconveyance of any mat- ers or facts shall be conclusive proof against all persons of the truthfulness thereof.

G. 1. Should breach or default be made by Trustor in payment of any indebtedness and/or in the performance of any obligation, covenant, prom-

ise or agreement herein mentioned, then Beneficiary may declare all sums secured hereby immediately due, and in such case, shall execute and deliver to Trustee a written Declaration of Default and Demand for Sale and shall surrender to Trustee this Deed of Trust, the note and receipts or other documents evidencing any expenditure secured hereby. Thereafter there shall be recorded in the office of the recorder of the county or counties wherein said real property or some part thereof is situated, a notice of such breach or default and of election to sell or cause to be sold the herein described property to satisfy the obligations hereof.

2. After three months shall have elapsed following such recordation of said notice, Trustee, without demand on Trustor, shall sell said property as herein provided, having first given notice of the time and place of such sale in the manner and for a time not less than that required by the laws of the State of California for sales of real property under Deeds of Trust.

3. Trustee may postpone sale of all, or any portion, of said property by public announcement at the time fixed by said notice of sale, and may thereafter postpone said sale from time to time by public announcement at the time fixed by the preceding postponement; and without further notice it may make such sale at the time to which the same shall be so postponed; provided, however, that the sale or any postponement thereof must be made at the place fixed by the original notice of sale.

4. At the time of sale so fixed, Trustee may sell
ne property so advertised, or any part thereof,
ther as a whole or in separate parcels at its sole
iscretion, at public auction, to the highest bidder
or cash in United States gold coin, all payable at
ime of sale, and after any such sale and due pay-
ent made, shall execute and deliver to such pur-
aser a deed or deeds conveying the property so
old, but without covenant or warranty, express or
nplied, regarding title, possession or incumbrances.
rustor hereby agrees to surrender immediately
nd without demand possession of said property to
uch purchaser. The recitals in such deed or deeds
f any matters or facts affecting the regularity or
alidity of said sale shall [64] be conclusive proof
f the truthfulness thereof and such deed or deeds
hall be conclusive against all persons as to all
atters or facts therein recited. Trustee, Benefic-
ary, any person on behalf of either, or any other
erson, may purchase at such sale.

H. Trustee shall apply the proceeds of any such
ale to payment of:

1. (a) Expenses of sale; (b) all costs, fees,
harges and expenses of Trustee and of these Trusts,
ncluding cost of evidence of title and Trustee's fee
n connection with sale;

2. All sums expended under the terms hereof,
ot then repaid, with accrued interest at the rate of
en per cent per annum;

3. Accrued interest on said note;

4. Unpaid principal of said note; or if more than one, the unpaid principal thereof pro rata and without preference or priority; and

5. The remainder if any to the person or persons legally entitled thereto, upon proof of such right.

I. This Deed of Trust in all its parts applies to, inures to the benefit of, and binds all parties hereto, their heirs, legatees, devisees, administrators, executors, successors and assigns.

J. Trustee accepts these Trusts when this Deed of Trust, duly executed and acknowledged, is made a public record as provided by law.

In this Deed of Trust, whenever the context so requires, the masculine gender includes the feminine and/or neuter, and the singular number includes the plural.

Witness the hand of Trustor, the day and year first above written.

(Signed) WILL ROGERS
(Signed) BETTY ROGERS

State of California
County of Los Angeles—ss.

On this 28th day of September, 1927, before me, undersigned, a Notary Public in and for said County, personally appeared Will Rogers and Betty Rogers, husband and wife, known to me to be the persons whose names are subscribed to the within

nstrument, and acknowledged that they executed he same.

Witness my hand and official seal.

(Signed) HENRY C. CLARKE, JR.
Notary Public in and for said
County and State.

Notarial Seal]

EXHIBIT B.

GRANT DEED.

Will Rogers and Betty Rogers, his wife in con-ideration of Ten and no/100 Dollars, to them in iand paid, receipt of which is hereby acknowledged, lo hereby [65] grant to California Trust Company, corporation, as Trustee under that certain Trust ndenture entered into between Pacific Palisades Association and California Trust Company, dated April 1, 1926, and recorded May 27, 1926, in the office of the County Recorder of Los Angeles County, California, in Book 6031, Page 1 of Official Records, and as modified by a certain Supplemental ndenture, the real property in the County of Los Angeles, State of California, described as

Lots One Hundred sixty-three (163) and One Hundred sixty-four (164) of Tract Number Seventeen Hundred Nineteen, in the County of Los Angeles, State of California, as per Map recorded in Book 21 Pages 162 and 163 of Maps, in the office of the County Recorder of said County.

Subject to conditions, restrictions, reserva-tions, easements, and rights of way of record and

Subject to all taxes for the fiscal year 1933-34 and thereafter; and also subject to all im-provement district taxes, assessments, and/or bonds, if any, now or hereafter a lien upon or assessed against said realty.

"This deed is an absolute conveyance, the consideration therefor, in addition to that above recited, being full satisfaction of all obligations secured by the deed of trust executed by Will Rogers and Betty Rogers, to Title Guarantee and Trust Company, trustee, for Oren B. Waite, beneficiary, recorded in Book 7661 Page 389 of Official Records of Los Angeles County."

"Grantors acknowledge that this conveyance is freely and fairly made; that the considera-tion received by grantors is equal to the fair value of grantors interest in said land, and that there are no agreements, oral or written, other than this deed between grantors and grantee with respect to said land."

To have and to hold to said Grantee, its succes-sors or assigns.

Witness our hands this 14th day of April, 1933.

WILL ROGERS

BETTY ROGERS

(Reverse side)

State of California
County of Los Angeles—ss.

On this 14th day of April, 1933, before me Pearl M. Stout, a Notary Public in and for said Los Angeles County, personally appeared Will Rogers [66] and Betty Rogers, his wife, known to me to be the persons whose names are subscribed to the foregoing instrument and acknowledged that they executed the same.

Witness my hand and official seal.

PEARL M. STOUT

Notary Public in and for said County and State.

My Commission expires Feb. 16, 1934.

[Title of Board and Cause—Docket No. 84895.]

STIPULATION OF FACTS.

It is hereby stipulated and agreed by and between the parties hereto, through their respective counsel of record, that the following are true and material facts involved in this cause and may be found as facts by the Board of Tax Appeals.

I.

Petitioner is an individual residing in the City of Beverly Hills, State of California.

II.

The taxes in controversy are income taxes of petitioner for the calendar year 1933 in the amount of $17,055.90.

III.

Paragraphs III to VII inclusive are omitted for the reason that they are substantially identical with Paragraphs IV to VIII inclusive of the preceding Stipulation of Facts. [67]

VIII.

Petitioner and her husband, Will Rogers, filed separate income tax returns for the year 1933. Petitioner duly filed her income tax return for the year 1933 with the Collector of Internal Revenue for the Sixth District of California, at Los Angeles, California. In her said income tax return for the year 1933, petitioner computed a loss on said transaction in the amount of $57,643.46 and deducted one-half of said sum, or, to-wit, $28,821.73, as an ordinary loss under the provisions of Section 23(e) of the Revenue Act of 1932, in computing her net taxable income for said year. Respondent reduced the amount of said loss to $54,055.25 and further determined that said loss was a capital loss within the meaning of Section 101 of the Revenue Act of 1932 and treated said loss as a capital loss in recomputing the tax liability of petitioner for the year 1933. The deficiency herein in controversy results from

respondent's determination that said loss was a capital loss.

Respectfully submitted,
CLAUDE I. PARKER
JOHN B. MILLIKEN
BAYLEY KOHLMEIER
Counsel for Petitioner
J. P. WENCHEL
Counsel for Respondent. [68]

The foregoing Stipulations of Fact were all of the evidence introduced on behalf of the respective petitioners in these cases. Respondent introduced no evidence. Thereupon counsel for petitioners and counsel for respondent stated that they had no further evidence to present and submitted the cases to the Member of the United States Board of Tax Appeals hearing the proceeding. Petitioners Betty Rogers and Betty Rogers, O. N. Beasley, Oscar Lawler and James K. Blake, executors of the estate of Will Rogers, deceased, tender and present the foregoing as their statement of evidence in this case as consolidated by order of the United States Circuit Court of Appeals and pray that the same may be approved by the United States Board of Tax Appeals and made a part of the record in this cause.

Respectfully submitted,
CLAUDE I. PARKER
JOHN B. MILLIKEN
BAYLEY KOHLMEIER
HARRIET GEARY
Attorneys for Petitioners [69]

[Title of Board and Cause—Docket Nos. 84895 and 84896.]

STIPULATION.

It is hereby stipulated by and between the parties to the above entitled cases through their respective counsel that the foregoing statement of evidence constitutes a statement of all the material evidence adduced at the hearing before the United States Board of Tax Appeals in said above entitled cases, and the same is approved by the undersigned as attorneys for the petitioners on review and by the undersigned, J. P. Wenchel, Chief Counsel for the Bureau of Internal Revenue, as attorney for the Commissioner of Internal Revenue, respondent on review. [70]

Dated this 29th day of September, 1938.

CLAUDE I. PARKER
JOHN B. MILLIKEN
BAYLEY KOHLMEIER
HARRIET GEARY
Counsel for Petitioners.

J. P. WENCHEL
Counsel for Respondent. [71]

[Title of Board and Cause—Docket Nos. 84895 and 84896.]

ORDER APPROVING STATEMENT OF EVIDENCE.

The foregoing Statement of Evidence constitutes all of the material evidence adduced at hearing of

the above entitled cases and in order that the same may be preserved and made a part of the record in said cases which have been ordered consolidated by the order of the Circuit Court of Appeals, this Statement of Evidence is duly approved and settled this 30th day of Sept., 1938.

(S) ARTHUR J. MELLOTT
Member of the United States
Board of Tax Appeals.

[Endorsed]: U. S. B. T. A. Lodged Sept. 29, 1938. Filed Sept. 30, 1938. [72]

[Title of Board and Cause—Docket Nos. 84895 and 84896.]

PRAECIPE FOR TRANSCRIPT.

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit copies, duly certified as correct, of the following documents and records in the above entitled causes in connection with the petitions for review by the said Circuit Court of Appeals for the Ninth Circuit heretofore filed by the above named petitioners.

1. Docket entries of all proceedings before the Board of Tax Appeals in Docket No. 84895.

2. Docket entries of all proceedings before the Board of Tax Appeals in Docket No. 84896. [73]

3. Petition for redetermination in Docket No. 84895 filed on May 29, 1936.

4. Petition for redetermination in Docket No. 84896 filed on May 29, 1936.

5. Answer to petition filed on June 30, 1936, in Docket No. 84895.

6. Answer to petition filed on June 30, 1936, in Docket No. 84896.

7. Opinion of the Board of Tax Appeals promulgated on May 18, 1938.

8. Decision of the Board of Tax Appeals in Docket No. 84895.

9. Decision of the Board of Tax Appeals in Docket No. 84896.

10. Petition for Review in Docket No. 84895 filed on August 13, 1938.

11. Petition for Review in Docket No. 84896 filed on August 13, 1938.

12. Notice for filing petition for review filed on August 13, 1938 in Docket No. 84895.

13. Notice for filing petition for review filed on August 13, 1938 in Docket No. 84896.

14. Stipulation for Consolidation for Review and Order for Consolidation for Review.

15. Statement of Evidence approved and filed on.., 1938.

16. This Praecipe for record. [74]

Said transcript to be prepared as required by law and the Rules of the United States Circuit Court of Appeals for the Ninth Circuit.

CLAUDE I. PARKER
JOHN B. MILLIKEN
BAYLEY KOHLMEIER
HARRIET GEARY
Attorneys for Petitioner.

Service of a copy of this Praecipe is hereby admitted this 29th day of September, 1938. Agreed to.

J. P. WENCHEL
Chief Counsel, Bureau of Internal Revenue, Attorney for Respondent.

[Endorsed]: U. S. B. T. A. Filed Sept. 29, 1938. [75]

[Title of Board and Cause—Docket Nos. 84895 and 84896.]

ORDER.

Upon consideration of the motion of the above-named petitioners on review, and it appearing to the Court that counsel for the respondent on review has consented to the granting thereof, it is, by the Court, this 15th day of September, 1938, ordered

1. That the motion is granted as made, and that the causes appearing in the caption hereof are hereby directed to be consolidated herein for briefing, hearing, argument, and decision upon a single

consolidated transcript of record, consisting of such portions of the record made before the United States Board of Tax Appeals as the parties herein may indicate by their praecipes for record.

And the Clerk of this Court is directed to transmit a certified copy of this order to the Clerk of the United States Board of Tax Appeals, to be by him incorporated in the record on review as certified and transmitted by him to this Court.

CURTIS D. WILBUR
U. S. Circuit Judge.

[Endorsed]: Filed September 19, 1938.

A true copy. Attest: Sept. 19, 1938.

[Seal] PAUL P. O'BRIEN,
Clerk.
By FRANK H. SCHMIDT,
Deputy Clerk.

[Endorsed]: U. S. B. T. A. Filed Sept. 24, 1938.
PAUL P. O'BRIEN,
Clerk. [76]

[Title of Board and Cause—Docket Nos. 84895 and 84896.]

CERTIFICATE.

I, B. D. Gamble, Clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 76, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on

file and of record in my office as called for by the Praecipe in the appeals as above numbered and entitled.

In testimony wherein, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 5th day of October, 1938.

[Seal] B. D. GAMBLE

Clerk, United States Board of Tax Appeals.

[Endorsed]: No. 9007. United States Circuit Court of Appeals for the Ninth Circuit. Betty Rogers, Petitioner, vs. Commissioner of Internal Revenue, Respondent, and Betty Rogers, O. N. Beasley, Oscar Lawler, James K. Blake, Executors of the Estate of Will Rogers, Deceased, Petitioners, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record Upon Petitions to Review Decisions of the United States Board of Tax Appeals.

Filed October 10, 1938.

PAUL P. O'BRIEN,

Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

No. 9007

In the United States Circuit Court of Appeals

For the Ninth Circuit.

BETTY ROGERS,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

and

BETTY ROGERS, O. N. BEASLEY, OSCAR LAWLER, JAMES K. BLAKE, Executors of the Estate of Will Rogers, Deceased,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONERS' OPENING BRIEF.

CLAUDE I. PARKER,
JOHN B. MILLIKEN,
BAYLEY KOHLMEIER,
HARRIET GEARY,
650 South Spring Street, Los Angeles,
Attorneys for Petitioners.

Parker & Baird Company, Law Printers, Los Angeles.

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No. 9007

In the United States Circuit Court of Appeals

For the Ninth Circuit.

BETTY ROGERS,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

and

BETTY ROGERS, O. N. BEASLEY, OSCAR LAWLER, JAMES K. BLAKE, Executors of the Estate of Will Rogers, Deceased,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONERS' OPENING BRIEF.

Jurisdictional Statement.

This is a consolidated appeal from a final order of the United States Board of Tax Appeals in two appeals affirming the action of the Commissioner of Internal Revenue in determining deficiencies for the calendar year 1933 against petitioner Betty Rogers in the sum of $17,055.90 and against petitioner Betty Rogers, O. N. Beasley, Oscar Lawler, James K. Blake, executors of the Estate of Will Rogers, deceased, in the sum of $16,894.61. [R. 46, 47.]

On March 4, 1936, in accordance with the provisions of Section 272(a) of the Revenue Act of 1932, as amended by Section 501 of the Revenue Act of 1934, the Commissioner of Internal Revenue, respondent herein, notified petitioners that the determination of petitioner Betty Rogers' and the decedent Will Rogers' income tax liability for the year 1933 disclosed the above mentioned deficiencies. [R. 11, 24.] From these determinations petitioners duly filed their appeals to the United States Board of Tax Appeals, in accordance with the provisions of said Section 272(a) of the Revenue Act of 1932 as amended by Section 501 of the Revenue Act of 1934. Said appeals were given docket number 84895 in the case of the appeal of Betty Rogers, petitioner, and docket number 84896, in the case of the appeal of Betty Rogers, O. N. Beasley, James K. Blake and Oscar Lawler, executors of the Estate of Will Rogers, deceased, petitioners.

Said appeals were called for hearing by the United States Board of Tax Appeals on September 27, 1937 at Los Angeles, California. [R. 2, 4.] At said hearing upon motion of counsel, it was ordered that said appeals be consolidated for the purpose of hearing and argument. Stipulations of facts were filed at said hearing, and these stipulations containing all the evidence to be presented, the appeals were submitted to the Board of Tax Appeals for decision. [R. 2, 4.]

On May 18, 1938, the Board of Tax Appeals promulgated its findings of fact and opinion in said appeals [R. 31] and on May 19, 1938, the Board of Tax Appeals entered its decisions and final orders determining deficiencies in petitioner Betty Rogers' income tax for the year 1933 in the amount of $17,055.90 and in decedent Will Rogers' income tax for said year 1933 in the amount of $16,894.61. [R. 46, 47.]

Petitioners being individuals, residing in California, and the income tax returns of petitioner Betty Rogers and decedent Will Rogers having been filed with the Collector of Internal Revenue for the Sixth District of California at Los Angeles, California, the appeals from the decisions and orders of the Board of Tax Appeals were brought to this Court. Separate petitions for review were filed on August 13, 1938 pursuant to the provisions of Section 1001-1003 of the Revenue Act of 1926, as amended by Section 603, Revenue Act of 1928, and Section 1101 of the Revenue Act of 1932, and Section 519 of the Revenue Act of 1934. [R. 47, 56.]

On September 19, 1938, this Court made its order consolidating the appeals herein for briefing, hearing, argument and decision upon a single consolidated transcript of record. [R. 89.]

Statement of Facts.

There is but one issue involved in this consolidated appeal, the facts in regard to which were stipulated by the parties before the Board of Tax Appeals, substantially identical Stipulations of Facts having been filed, in the two appeals before the Board and incorporated in the Statement of Evidence approved by the Board as part of the record in this consolidated appeal. [R. 64, *et seq.*]

Petitioners are individuals residing in the County of Los Angeles, State of California, and petitioners Betty Rogers, O. N. Beasley, Oscar Lawler and James K. Blake are the duly appointed, qualified and acting executors of the Estate of Will Rogers, deceased. [R. 66.] Decedent Will Rogers, a resident of the City of Beverly Hills, California, died testate on August 15, 1935 [R. 66] and on September 17, 1935, petitioners were appointed

executors of his estate. [R. 66.] During September, 1927 petitioner Betty Rogers and her husband, decedent Will Rogers, purchased from Oren B. Waite certain real property in the County of Los Angeles, State of California, described as lots 163 and 164, tract 1719, as per map recorded in book 21, pages 162 and 163 of maps in the office of the County Recorder of Los Angeles County. [R. 67.] The total purchase price of this property was $105,000.00 payable as follows: $15,000.00 cash at the time of the purchase, the assumption of a note in the amount of $52,000.00, which note was secured by a mortgage on the property and became due and payable in 1930, and the giving of a promissory note for the balance to be secured by a trust deed on the property. [R. 67.]

In September, 1927, petitioner Betty Rogers and her husband Will Rogers paid the $15,000.00 cash and assumed payment of the $52,000.00 note. [R. 67.] Also in September, 1927 petitioner and her husband executed to the seller, Oren B. Waite, their promissory note in the amount of $38,000.00, which note was made payable to Oren B. Waite or his order, was dated August 19, 1927 and provided for the payment of interest at the rate of 7 per cent per annum. [R. 67-68.] The note was payable on or before August 19, 1932. Accordingly the above described property was conveyed to petitioner and her husband, subject to the mortgage for $52,000.00, and immediately thereafter petitioner and her husband conveyed the property to the Title Guarantee and Trust Company, as trustee, to be held in trust for the payment of the promissory note in the amount of $38,000.00. [R. 68.] The deed of trust by which this promissory note of $38,000.00 was secured is set forth in full in the record in this appeal at page 72. This property was acquired by Will Rogers

and his wife, petitioner Betty Rogers, as community property. [R. 68.] It was business property and the acquisition thereof by Mr. and Mrs. Rogers was a transaction entered into for profit. [R. 68.] Prior to 1933 Mr. and Mrs. Rogers paid in full the note in the amount of $52,000.00 which had been assumed by them at the time of the purchase of the property. [R. 68.] Also prior to 1933 the $38,000.00 note payable to Oren B. Waite and the beneficial interest under the deed of trust which secured said note had been transferred and assigned to the California Trust Company. [R. 69.] On August 19, 1932 this note in the amount of $38,000.00 became due and payable. [R. 69.] It was not paid on the due date and on August 25, 1932 payment of said note and the interest accrued thereon was demanded of Mr. and Mrs. Rogers and notice was given that unless the principal and interest were paid, the holder of the note would proceed to enforce its rights under the provisions of the deed of trust given to secure payment of the indebtedness. [R. 69.]

Thereafter it was agreed by and between decedent Will Rogers and petitioner Betty Rogers and the holder of the $38,000.00 note and trust deed that the property be conveyed by decedent and his wife to the holder of the note and that the note be cancelled and surrendered. Thereafter the property was reconveyed by Title Guarantee and Trust Company, the trustee in the deed of trust which secured said $38,000.00 note to petitioner and her husband, and on April 21, 1933, they conveyed the property to the California Trust Company and the note in the amount of $38,000.00 was surrendered and cancelled. The deed by which the conveyance was made is set forth in full at page 81 of the record.

Before the relinquishment of their interest in the property and the cancellation and surrender of their note, peti-

tioner Betty Rogers and her husband had paid $67,000.00 toward the purchase price of the property and, in addition thereto, had paid escrow expenses in the amount of $212.02. [R. 70.] For the years 1927 to 1932 inclusive, petitioner Betty Rogers and her husband had claimed and were allowed depreciation on the improvements on this property in the total amount of $13,156.77. [R. 70.] Thus the total unrecovered cash investment in the property was $54,055.25. [R. 70.] Therefore, Will Rogers and Betty Rogers each sustained a loss in the year 1933 from the transaction in the amount of $27,027.62. [R. 70.]

Will Rogers and Betty Rogers filed separate income tax returns for the year 1933. [R. 70.] Each of these returns were filed with the Collector of Internal Revenue for the Sixth District of California at Los Angeles, California. [R. 70, 84.] In his return for said year, Will Rogers computed a loss on this transaction in the amount of $57,643.46 and deducted one-half of this sum or $28,821.73 as an ordinary loss under the provisions of Section 23(e) of the Revenue Act of 1932, in computing his net taxable income for said year. [R. 71.] Petitioner Betty Rogers likewise computed a loss on this transaction in the amount of $57,643.46 and deducted one-half of the sum or $28,821.73 as an ordinary loss under the same section of the same Revenue Act. Respondent reduced the amount of the total loss of Will Rogers and Betty Rogers to $54,055.25 and further determined that the loss was a capital loss within the meaning of Section 101 of the Revenue Act of 1932 and treated this loss as a capital loss in recomputing the tax liability of petitioner Betty Rogers and decedent Will Rogers for that year.

The deficiencies here in controversy result from respondent's determination that the loss suffered was a capital

one [R. 71] and therefore the sole question or issue before this Court to determine is whether or not, under the facts above stated, the loss suffered can be said as a matter of law to be an ordinary or a capital loss within the meaning of the applicable sections of the Revenue Act of 1932.

Specifications of Error.

1. The Board of Tax Appeals erred in finding and determining that the loss suffered by petitioner Betty Rogers and decedent Will Rogers in the transaction culminating in their relinquishment of their equity in real property to the seller of such property in payment of the remaining portion of the purchase price and their forfeiture of the purchase price payments already made constituted a capital loss rather than an ordinary loss. (Assignments of Error 1-5, inclusive, Docket No. 84895 [R. 51-53] and Assignments of Error 1-5, inclusive, Docket No. 84896 [R. 60-62]. These assignments are set forth in full immediately preceding Argument.)

Summary of Argument.

(a) The loss suffered in the instant case was not a capital loss for the reason that it did not result from the sale or exchange of a capital asset.

(1) Payment of an obligation does not result in a sale or exchange.

(2) In order for there to have occurred a sale or exchange, parties to any transaction must receive something of exchangeable value.

(b) The decision of the Board of Tax Appeals in the case at bar is inconsistent with and contrary to its recent decisions where taxpayers have lost property by foreclosure or transactions in lieu of foreclosure.

ARGUMENT.

Assignments of Error—Docket No. 84895:

1. The United States Board of Tax Appeals erred in ordering a deficiency in petitioner's income tax for the calendar year 1933 in the amount of $17,055.90. [R. 51.]

2. The United States Board of Tax Appeals erred in deciding that the loss sustained by petitioner in the year 1933 on reconveyance of the property in question in payment and cancellation of her and her husband's liability on their outstanding note leaving unrecovered a cash investment in the property in the amount of $27,027.62 was a capital loss for income tax purposes for the reason that as a matter of law the loss occurring under such circumstances constituted an ordinary loss under the applicable Revenue Act. [R. 51.]

3. The United States Board of Tax Appeals erred in holding that the loss sustained by a purchaser of real property upon reconveyance of said property to cancel the balance due on the purchase money note and forfeiture of prior cash payments, constituted a capital rather than an ordinary loss under the Revenue Act of 1932. [R. 52.]

4. The United States Board of Tax Appeals erred as a matter of law in deciding that the reconveyance of purchased premises, subject to a trust deed given to secure the payment of a purchase money note, in cancellation of

the indebtedness thereon, constituted a sale of a capital asset, the loss suffered from the sale of which was a capital loss. [R. 52.]

5. The United States Board of Tax Appeals erred in ordering that petitioner was not entitled to deduct for income tax purposes an ordinary loss in the amount of $27,027.62 in the calendar year 1933 by reason of the reconveyance of certain property, which she had purchased and which was subject to a trust deed to secure the payment of the remainder of the purchase price, and forfeiture of the cash purchase price theretofore paid thereon, for the reason that such order of the United States Board of Tax Appeals is contrary to the facts stipulated by the parties to this proceeding and the law applicable thereto. [R. 52.]

Assignments of Error—Docket No. 84896:

1. The United States Board of Tax Appeals erred in ordering a deficiency income tax of Will Rogers, deceased, for the calendar year 1933 in the amount of $16,894.61. [R. 60.]

2. The United States Board of Tax Appeals erred in deciding that the loss sustained by Will Rogers, deceased in the year 1933 on reconveyance of the property in question in payment and cancellation of his and his wife's liability on their outstanding note leaving unrecovered a

cash investment in the property in the amount of $27,-027.63, was a capital loss for income tax purposes for the reason that as a matter of law the loss occuring under such circumstances constituted an ordinary loss under the applicable Revenue Act. [R. 60.]

3. The United States Board of Tax Appeals erred in holding that the loss sustained by a purchaser of real property upon reconveyance of said property to cancel the balance due on the purchase money note and forfeiture of prior cash payments constituted a capital rather than an ordinary loss under the Revenue Act of 1932. [R. 61.]

4. The United States Board of Tax Appeals erred as a matter of law in deciding that the reconveyance of purchased premises subject to a trust deed given to secure the payment of a purchase money note, in cancellation of the indebtedness thereon constituted a sale of a capital asset, the loss suffered from the sale of which was a capital loss. [R. 61.]

5. The United States Board of Tax Appeals erred in ordering that Will Rogers was not entitled to deduct for income tax purposes and ordinary loss in the amount of $27,027.63 in the calendar year 1933 by reason of the reconveyance of certain property which he had purchased and which was subject to a trust deed to secure the payment of the remainder of the purchase price and forfeiture of the cash purchase price theretofore paid thereon, for the reason that such order of the United States Board of Tax Appeals is contrary to the facts stipulated by the parties to this proceeding and the law applicable thereto. [R. 61.]

(a) The Loss Suffered in the Instant Case Was Not a Capital Loss for the Reason That It Did Not Result From the Sale or Exchange of a Capital Asset.

1. Payment of an Obligation Does Not Result in a Sale or Exchange.

It is believed that the issue involved in this case, as it is defined by the specific facts, is one which has never been passed upon by the Courts or the Board of Tax Appeals in any instance other than the decision in these cases before the Board of Tax Appeals. However, the underlying principle disclosed by an analysis of these facts is not new and has been decided by the Courts and the Board of Tax Appeals in cases so analogous to the instant case as to be indistinguishable. Such decisions have been in accord with petitioner's contentions.

A brief summary of the events which define the present issue shows that the taxpayers (petitioner Betty Rogers and decedent Will Rogers) entered into a contract of purchase of real property, paying for the property a substantial amount in cash and assuming the liability for payment of an already existing encumbrance and executing a note secured by a trust deed to the seller for the balance of the purchase price. The purchase price, with the exception of the note in favor of the seller, was paid before August, 1932. At that time the note in favor of the seller came due but was not paid. Suit was threatened and thereafter, in order to pay the obligation, the taxpayers relinquished their equity in the property to the sellers' assignees in return for the cancellation of their indebtedness, suffering as a loss the entire purchase price already paid. The amount of the loss suffered is not in question in this case, the sole question for determination

being whether as a matter of law the taxpayers' loss should be treated as an ordinary loss, as petitioners contend, or whether it should be treated as a capital loss as is urged by the respondent.

The sections of the Revenue Act of 1932 which pertain to a determination of the above question, are as follows:

"Section 23. Deductions from Gross Income.

"In computing net income there shall be allowed as deductions:

* * * * * * * * *

"(e) Losses by Individuals.—Subject to the limitations provided in subsection (r) of this section, in the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

* * * * * * * * *

"(2) If incurred in any transaction entered into for profit, though not connected with the trade or business;" * * *

"Sec. 101. Capital Net Gains and Losses.

* * * * * * * * *

"(b) Tax in Case of Capital Net Loss.—In the case of any taxpayer, other than a corporation, who for any taxable year sustains a capital net loss (as hereinafter defined in this section), there shall be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted, and the total tax shall be in this amount minus 12½ per

centum of the capital net loss; but in no case shall the tax of a taxpayer who has sustained a capital net loss be less than the tax computed without regard to the provisions of this section.

"(c) * * *

"(2) 'Capital loss' means deductible loss resulting from the sale or exchange of capital assets."

* * * * * * * * *

"(8) 'Capital Assets' means property held by the taxpayer for more than two years (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale in the course of his trade or business." * * *

It is clear from a reading of the statutes above quoted that the loss suffered by the taxpayers in the case at bar is one which is deductible for income tax purposes since it resulted from a transaction entered into for profit. [R. 68, 84.] (Sec. 23 (e) (2).) It is likewise clear by the definition contained in the statute itself that the loss cannot be treated as a capital loss for income tax purposes unless it resulted "from the sale or exchange of capital assets".

Petitioners submit that the series of events at the culmination of which petitioner Betty Rogers and decedent Will Rogers had nothing which they did not have at the commencement of the transaction, but were concededly out of pocket to the extent of some $54,000.00, did not constitute such sale or exchange.

It is a familiar tenet of the law, repeatedly reiterated by the Courts, that in interpreting taxing statutes the language should be taken in its ordinary meaning. (*Hale v. Helvering,* 85 Fed. (2d) 819 (C. A. D. C.—1936); *John H. Watson v. Commissioner,* 27 B. T. A. 463 (1932).) This rule has been stated by the United States Supreme Court in *Old Colony R. R. Co. v. Commissioner,* 284 U. S. 552, 560, 52 Sup. Ct. 211, 76 L. Ed. 484, as follows:

> "The rule which should be applied is established by many decisions. 'The legislature must be presumed to use words in their known and ordinary signification.' Levy v. M'Cartee, 6 Pet. 102, 110, 8 L. ed. 334, 337. 'The popular or received import of words furnishes the general rule for the interpretation of public laws.' Maillard v. Lawrence, 16 How 251, 261, 14 L. ed. 925, 930. And see United States v. Buffalo Natural Gas Fuel Co., 172 U. S. 339, 341, 43 L. ed. 469, 470, 19 S. Ct. 200; United States v. First Nat. Bank, 234, U. S. 245, 258, 58 L. ed. 1298, 1303, 34 S. Ct. 846; Caminetti v. United States, 242 U. S. 470, 485, 61 L. ed. 442, 452, L. R. A. 1917F, 502, 37 S. Ct. 192, Ann. Cas. 1917B, 1168. As was said in Lynch v. Alworth-Stephens Co., 267 U. S. 364, 370, 69 L. ed. 660, 662, 45 S. Ct. 274, "the plain, obvious and rational meaning of a statute is always to be prefered to any curious, narrow, hidden sense that nothing but the exigency of a hard case and ingenuity and study of an acute and powerful intellect would discover.' This rule is applied to taxing acts: De Ganay v. Lederer, 250 U. S. 376, 381, 63 L. ed. 1042, 1044, 39 S. Ct. 524."

Quoting and applying this rule, the Court of Appeals for the District of Columbia in *Hale v. Helvering, supra,* has held that an ordinary as distinguished from a capital

loss was sustained in the following situation. During the year 1925 the Hale brothers sold an orange grove for the sum of $60,000.00. Title was transferred to the purchaser upon payment of $20,000.00 in cash and $40,000.00 in notes secured by a first mortgage. The brothers each reported their pro-rata share of the profit on the transaction in 1925 and paid the tax due thereon. Upon maturity of the notes in 1927, the maker, although financially able, refused to pay. During the year 1929 suit was commenced to collect the notes. Prior to judgment a settlement was entered into which resulted in loss to each of the Hale brothers of approximately $7,500.00. The Commissioner refused to allow the deduction of such loss by the Hale brothers as a capital loss, but asserted that it was allowable only as a bad debt. In determining that the loss suffered was not a capital loss for the reason that it did not arise from the sale or exchange of a capital asset, the Court states:

> "There was no acquisition of property by the debtor, no transfer of property to him. Neither businessmen nor lawyers call the compromise of a note a sale to the maker. In point of law and in legal parlance, property in the notes as capital assets was extinguished, not sold. In business parlance, the transaction was a settlement and the notes were turned over to the maker, not sold to him."
>
> *Hale v. Helvering,* 85 Fed. (2d) 819, 821.

Thus it appears that a loss suffered by mortgagee in a transaction similar to the one in the case at bar has been held not to result in capital loss. It would seem incredible

that a different rule should apply when it is the mortgagor who suffers the loss as in the instant case. What was actually accomplished in *Hale v. Helvering,* and likewise in the case at bar, as well as in certain other Court and Board cases to be hereinafter discussed, was that a debt existing between two persons standing in the position of debtor and creditor was satisfied and paid.

It has frequently been held by the Courts and the Board of Tax Appeals that the payment of a debt does not constitute a sale or exchange of property and, therefore, does not result in capital gain or loss.

In *John H. Watson, Jr. v. Commissioner,* 27 B. T. A. 463 (1932), it was held that the payment at maturity of the face amount of bonds purchased at a premium was not a sale or exchange resulting in a capital loss.

Again in *George A. Hellman, Commissioner,* 33 B. T. A. 901 (1936), it was held that the gain realized upon the surrender of combined insurance and annuity policies was taxable as ordinary income and could not be treated as capital gain for the reason that such surrender did not constitute a sale or exchange. So also in *United States v. Fairbanks,* 95 Fed. (2d) 794 (C. C. A. 1938), decided just this year by this Court and citing and following the *John H. Watson, Jr.* case, *supra,* it was held that the gain realized on the redemption of debenture bonds was not a capital gain but an ordinary one.

The principle upon which all of the above cited cases were decided was the same; namely, that the payment of an obligation does not effect a sale or exchange and that therefore the gain or loss on such disposition of the asset affected cannot be a capital one. The cases holding in

accord with this principle are legion, among which are: *Arthur E. Braun v. Commissioner*, 29 B. T. A. 1161 (1934); *Ernest W. Brown v. Commissioner*, 36 B. T. A. 182 (1937); *Felin v. Kyle*, 22 Fed. Supp. 556 (D. C. Pa. 1938). Interestingly enough respondent appears to agree with this principle and it is submitted that the position he takes in the instant case is inconsistent. Respondent gave notice of his acquiescence in the case of *John H. Watson, Jr., supra,* and in the other cases above cited where there was a gain instead of a loss involved, he was successful in his contention that the capital gain rates were not applicable. Therefore, applying this principle to the case at bar, it is apparent that there can have been no sale or exchange, since the petitioner Betty Rogers and her husband by relinquishing their equity merely paid their obligation.

2. In Order for There to Have Occurred a Sale or Exchange, Parties to Any Transaction Must Receive Something of Exchangeable Value.

Furthermore, for another reason, which has been held by the Courts to negative the existence of a sale or exchange, there can be said to have occurred no sale or exchange in the case at bar. An essential element of a sale or exchange is that something of exchangeable value be received by the parties to the transaction. This principle was recognized and relied upon in the recent holding of this Court in *Chester N. Weaver Co. v. Commissioner*, 97 Fed. (2d) 31 (C. C. A. 9th 1938), wherein this Court held that a taxpayer surrendering its preferred stock and receiving a liquidating dividend could deduct as a loss the

difference between the amount paid for the stock and the amount of the dividend as against the contention that loss was from an exchange of stock and was not deductible because taxpayer had no capital gains against which to offset such loss. The opinion states: "A 'sale or exchange' implies, we think, that each party to the transaction shall obtain something".

Such also was the opinion of the Circuit Court of Appeals for the Fifth Circuit in *Dallas Transfer & Terminal Warehouse Co. v. Commissioner,* 70 Fed. (2d) 95 (1934), wherein the Court decided that a taxpayer realized no income when it transferred to its lessor property of a value of some $17,500 in return for the cancellation of its obligation in the amount of approximately $108,000.00. The Court states:

> "The transaction was not in form or substance a sale for $107,880.77 of property which had an appraised value of $17,507.20. * * * Taxable income is not acquired by a transaction which does not result in the taxpayer getting or having anything he did not have before. Gain or profit is essential to the existence of taxable income. A transaction whereby nothing of exchangeable value comes to or is received by a taxpayer does not give rise to or create taxable income."

Applying this principle to the instant case, it appears that petitioner Betty Rogers and her husband received nothing of exchangeable value in the course of the events under consideration here. At the culmination of the entire transaction Mr. and Mrs. Rogers had actually lost some $54,000 in money paid out and received nothing for it.

(b) The Decision of the Board of Tax Appeals in the Case at Bar Is Inconsistent and Contrary to Its Recent Decisions Where Taxpayers Have Lost Property by Foreclosure or Transactions in Lieu of Foreclosure.

By a series of recent decisions by the Board of Tax Appeals commencing with *Commonwealth, Inc. v. Commissioner*, 36 B. T. A. 850 (1937), and continuing with *Godfrey S. Hammel v. Commissioner*, 36 B. T. A. 1331 (1937); *H. L. Rust, Jr. v. Commissioner*, 38 B. T. A. ...., No. 115 (Oct. 18, 1938, Docket No. 89171), Commerce Clearing House, Dec. No. 10,467, and *C. Griffith Warfield v. Commissioner*, 38 B. T. A. ...., No. 114 (Oct. 18, 1938, Docket No. 89170), Commerce Clearing House, Dec. No. 10,466, the Board of Tax Appeals has determined with regard to loss on mortgage transactions inconsistent with its holding in the case at bar as follows: In *Commonwealth, Inc., supra,* the facts were that the petitioner had purchased property subject to a mortgage. When the note secured by the mortgage became due and was not paid, the petitioner in lieu of suffering foreclosure proceedings conveyed its equity to the mortgagee. The Board held that the petitioner suffered ordinary loss as distinguished from a capital loss to the extent of the purchase price paid prior to the conveyance.

In *Godfrey S. Hammel, supra,* the petitioner was the mortgagor of property which was foreclosed and sold at sheriff's sale. The Board held that the loss suffered by the mortgagor in this instance was an ordinary loss, as distinguished from a capital loss. Such likewise was the

holding in cases of *H. L. Rust, Jr., supra,* and *C. Griffith Warfield, supra.* In each of these cases the Board looked at the true facts of the situation and determined that no sale or exchange had taken place. Thus an anomalous condition of the law with regard to this subject is presented by these cases and the instant case.

1. Where a mortgagor loses property by foreclosure, the loss suffered by him is deemed an ordinary loss. (*Godfrey S. Hammel, supra.*)

2. Where a person, not the original mortgagor, abandons property to the mortgagee in lieu of suffering foreclosure proceedings, the loss suffered by him is likewise deemed to be an ordinary loss.

3. And yet in the case where substantially no different result is reached, that is, where the mortgagor of property abandons the property to the mortgagee, the loss according to the Board of Tax Appeals' opinion in the instant case is deemed to be a capital loss.

Viewed from a practical point of view, it seems that what actually happened in the instant case was that Mr. and Mrs. Rogers merely abandoned the property which they started to purchase in lieu of submitting to foreclosure proceedings. Certainly the loss in this situation is just as real and of the same type or character as the loss in the situation where property is taken by foreclosure and to assert that there is no sale or exchange on a mortgage foreclosure, but that there is one on a voluntary abandonment to a mortgagee in lieu of foreclosure seems indicate a distinction without a difference. To follow

through the contentions of respondent to their logical conclusion, it appears that a man about to lose his property on foreclosure must necessarily resist foreclosure and have the case go to Court and be determined there and thereby put himself to additional expense and entail additional loss in order that the loss which he is bound to suffer may be deemed an ordinary loss instead of a capital loss. Viewed in this light the contentions of the respondent appear incredible and such a situation demonstrates clearly how out of line with the existing law are such contentions.

In conclusion, it is submitted that by reason of the fact that there was present in the instant case merely the payment of a debt, and, therefore, no sale or exchange, and further that a holding for the respondent in the instant case would be contrary to the existing law with regard to mortgage foreclosures and transactions in lieu of foreclosure, the decisions of the Board of Tax Appeals in the instant cases should be reversed.

Respectfully submitted,

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No. 9007

In the United States Circuit Court of Appeals for the Ninth Circuit

BETTY ROGERS, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

AND

BETTY ROGERS, O. N. BEASLEY, OSCAR LAWLER, JAMES K. BLAKE, EXECUTORS OF THE ESTATE OF WILL ROGERS, DECEASED, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

UPON PETITIONS TO REVIEW DECISIONS OF THE UNITED STATES BOARD OF TAX APPEALS

BRIEF FOR THE RESPONDENT

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FILED

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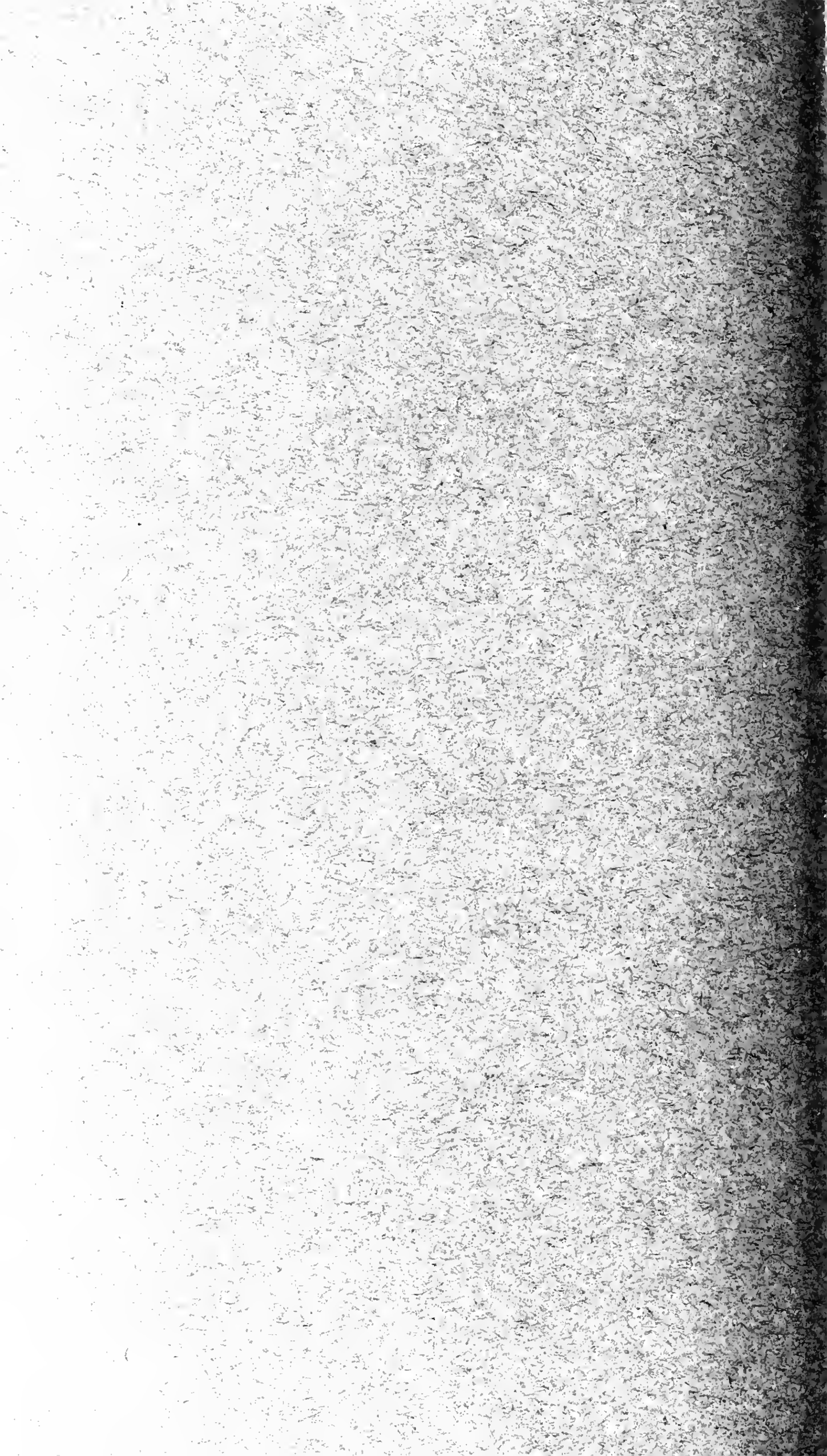
PAUL P. O'BRIEN,



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In the United States Circuit Court of Appeals for the Ninth Circuit

No. 9007

Betty Rogers, petitioner

v.

Commissioner of Internal Revenue, respondent

AND

Betty Rogers, O. N. Beasley, Oscar Lawler, James K. Blake, executors of the estate of Will Rogers, Deceased, petitioners

v.

Commissioner of Internal Revenue, respondent

UPON PETITIONS TO REVIEW DECISIONS OF THE UNITED STATES BOARD OF TAX APPEALS

BRIEF FOR THE RESPONDENT

OPINION BELOW

The only previous opinion in these cases is that of the United States Board of Tax Appeals (R. 31–45), which is reported in 37 B. T. A. 897.

JURISDICTION

The petitions for review herein involve the individual and estate income tax liabilities of the peti-

tioners in the amounts of $17,055.90 (R. 11–17, 32, 46, 49), and $16,894.61 (R. 24–30, 32, 46–47, 58), respectively, for the taxable year 1933, and are taken from decisions of the Board of Tax Appeals entered May 19, 1938 (R. 46–47). The cases are brought to this Court by petitions for review [1] filed August 13, 1938 (R. 47–55, 56–64), pursuant to the provisions of Sections 1001–1003 of the Revenue Act of 1926, c. 27, 44 Stat. 9, as amended by Section 1101 of the Revenue Act of 1932, c. 209, 47 Stat. 169, and by Section 519 of the Revenue Act of 1934, c. 277, 48 Stat. 680.

QUESTION PRESENTED

Whether the marital community loss sustained by petitioners in the taxable year was a statutory capital net loss or an ordinary loss within the meaning of the statute.

STATUTE INVOLVED

Revenue Act of 1932, c. 209, 47 Stat. 169:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> *   *   *   *   *
>
> (e) *Losses by individuals.*—Subject to the limitations provided in subsection (r) of this

[1] Both cases involve the same question and were consolidated for hearing and opinion before the Board (R. 32–33, 65) upon motion of petitioners, concurred in by counsel for the respondent. This Court entered an order consolidating the causes for briefing, hearing and decision upon a single, consolidated transcript of record. (R. 89–90.)

section, in the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

* * * * *

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business. * * *

SEC. 101. CAPITAL NET GAINS AND LOSSES.

* * * * *

(b) *Tax in case of capital net loss.*—In the case of any taxpayer, other than a corporation, who for any taxable year sustains a capital net loss (as hereinafter defined in this section), there shall be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted, and the total tax shall be this amount minus 12½ per centum of the capital net loss; but in no case shall the tax of a taxpayer who has sustained a capital net loss be less than the tax computed without regard to the provisions of this section.

(c) *Definitions.*—For the purposes of this title—

* * * * *

(2) "Capital loss" means deductible loss resulting from the sale or exchange of capital assets.

* * * * *

(6) "Capital net loss" means the excess of the sum of the capital losses plus the

capital deductions over the total amount of capital gain.

* * * * *

(8) "Capital assets" means property held by the taxpayer for more than two years (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale in the course of his trade or business. * * *

STATEMENT

The material facts were summarized and found by the Board of Tax Appeals (R. 33–35), pursuant to stipulations entered into between the parties (R. 66–71, 83–85), as follows:

The petitioner, Betty Rogers, a resident of California, is the widow of Will Rogers, who died testate, a resident of California, on August 15, 1935. She and the other petitioners were appointed executors of the estate of the decedent by the Superior Court of the State of California in and for the County of Los Angeles, on September 17, 1935. (R. 33.)

During September, 1927, the decedent and his wife purchased for profit certain business real estate situated in the county of Los Angeles, California, at a price of $105,000, payable as follows: $15,000 cash at the time of purchase, the assump-

tion of a note in the amount of $52,000, which was secured by a mortgage on such property and became due and payable in 1930, and the giving of their promissory note for the balance of $38,000, secured by a trust deed on the property. (R. 33.)

The decedent and his wife paid the $15,000 cash and prior to 1933 paid in full the $52,000 note. (R. 33.)

The note for $38,000 and the beneficial interest under the deed of trust which secured it were transferred and assigned to the California Trust Company, a corporation. The note became due and payable on August 19, 1932. (R. 33.)

On August 25, 1932, payment of the note and accrued interest thereon was demanded of decedent and his wife and notice was given that, unless the principal and interest were paid, the holder of such note would proceed to enforce its rights under the provisions of the deed of trust given to secure payment of it. (R. 33–34.)

Thereafter it was agreed by and between decedent and his wife and the holder of the $38,000 note and trust deed that the property be conveyed by the former to the latter and that the note be canceled and surrendered. Thereafer the property was reconveyed by the Title Guarantee & Trust Company to the decedent and his wife and on April 21, 1933, they transferred and conveyed it to the California Trust Company, and the $38,000 note was surrendered to decedent and his wife and canceled. (R. 34.)

In addition to the $67,000 paid by the decedent and his wife upon the purchase price of the property they also paid, prior to April 21, 1933, escrow expenses in the amount of $212.02, or a total of $67,212.02. For the years 1927 to 1932, inclusive, they were allowed depreciation on the improvements on the property in the total amount of $13,156.77. Their total unrecovered cash investment in such property at the time of its conveyance to the California Trust Company was $54,055.25. The decedent and his wife each sustained a loss in 1933 from the transaction in the amount of $27,027.62. (R. 34.)

The decedent and his wife filed separate returns for 1933. They computed a loss on the transaction in the amount of $57,643.46 and each deducted one-half of that sum, or $28,821.73, as an ordinary loss, under the provisions of Section 23 (e) of the Revenue Act of 1932. The respondent reduced the amount of the loss to $54,055.25, and, in recomputing the tax liability of each of them, treated the loss as a capital loss within the meaning of Section 101 of the Revenue Act of 1932. The deficiencies result from respondent's determination that the loss was a capital loss. (R. 34–35.)

Upon the basis of the foregoing facts, the Board affirmed the Commissioner's determination that the loss sustained by petitioners was a capital loss (R. 45), and entered its decisions accordingly (R. 46–47). From the decisions so entered, the

taxpayers petitioned this Court for review. (R. 47, 56.)

SUMMARY OF ARGUMENT

The marital community loss sustained by petitioners was clearly a statutory capital loss and not an ordinary one under the statute. The statute defines "capital assets" as property held by a taxpayer for more than two years. Petitioners purchased the property herein in 1927 and it was deeded to them subject to encumbrances. It is not necessary that a taxpayer own property outright in order to come within the purview of the statute since it is required merely that property be "held" for more than two years. Petitioners conveyed the property in 1933 by Grant Deed which of course implies a sale. Moreover, they do not contend that they did not own the property or that it was not a capital asset within the meaning of the statute. It is therefore not clear how the property, being a statutory capital asset, could have been disposed of at a loss without a statutory capital loss resulting.

Petitioners contend that it was not a capital loss because it did not result "from the sale or exchange of capital assets," as required by the terms of the statute and that the transaction constituted merely the satisfaction and payment of an existing debt for the reason that they received nothing in exchangeable value in return and had nothing in the end which they did not have in the beginning, except a $54,000 loss. This argument is untenable, however,

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since the deed of conveyance shows that they received as consideration $10 in cash and cancellation and surrender of their outstanding $38,000 note, and "that the consideration received by grantors (petitioners) is equal to the fair value of grantors' interest in said land." This in itself concedes a valuable consideration. If they had received nothing in exchangeable value in return, their loss would have been almost twice as large as they claimed. It is settled that release from liability is a valuable consideration. Moreover, if they had conveyed the property for $38,000 cash and used the money to pay the note, they would have unquestionably made a sale and the situation was not changed when they handled the transaction as they did. From the foregoing it is apparent that we have all the essential elements of a valid sale. It follows that the loss, suffered upon the sale or exchange of a capital asset held by petitioners for more than two years, is a statutory capital loss deductible only as such.

Even if the transaction be treated as an exchange instead of a sale, the same result follows since there is no substantial difference between a sale and an exchange. In either case title to the property is absolutely transferred and the same rules of law apply to the transaction.

The cases relied upon by petitioners are distinguishable or have no application to the facts herein since, as petitioners state, the issue involved

is one which has never been passed upon by the courts, or by the Board except in the instant cases.

ARGUMENT

The marital community loss sustained by petitioners upon the disposition of their real property in the taxable year is a statutory capital loss, and not an ordinary loss, within the meaning of the statute

The respondent determined that the transaction whereby petitioners transferred the property in 1933, full title to which they had acquired in 1927, in consideration for the cancellation of their outstanding note given in payment thereof, amounted to an exchange of one asset for another—real estate for a trust deed note—and that therefore the loss suffered on the disposition of the property is a capital loss under the provisions of Section 101 of the Revenue Act of 1932, *supra*. (R. 16–17, 29, 32.)

The Board held that the property was deeded to petitioners subject to the indebtedness which they assumed and paid, and therefore it is a statutory capital asset acquired in a transaction entered into for profit, and was held by the taxpayers for more than two years (R. 36); that upon transfer of the property to their creditor, petitioners not only paid a debt—which of itself does not entitle them to a loss deduction—but also were released from their promise to pay the $38,000 note (hereinafter called the note) (R. 38); that therefore, under the authorities, their disposal of the property constituted

either a sale or an exchange—preferably a sale—of all their right, title and interest in the property for the price of their obligation (R. 39); that no mere compromise of a note is involved for the reason that if petitioners had transferred the property for $38,000 cash and had paid the note therewith, they would have made a sale of the property (R. 42); and that, accordingly, the respondent's determination that they sustained a capital loss is correct (R. 45).

Petitioners contend that the loss suffered was not a statutory capital loss since it did not result "from the sale or exchange of capital assets", and that in the end, they had nothing they did not have in the beginning but were concededly out of pocket to the extent of approximately $54,000 (Br. 11–13); that giving the ordinary meaning to the language of the statute, an ordinary loss, as distinguished from a capital loss, was sustained herein for the reason that the transaction constituted merely the satisfaction and payment of a debt existing between two persons standing in the position of debtor and creditor and, under the authorities, payment of a debt does not constitute a sale or an exchange of property (Br. 14–17); that at the culmination of the transaction, petitioners had lost approximately $54,000 in money paid out but had received nothing of exchangeable value in return with the result that there was no sale or exchange of the property (Br. 17–18); and that the Board's decisions herein are

inconsistent with and contrary to its other decisions wherein taxpayers lost their property through foreclosure proceedings or in similar transactions (Br. 19).

It is our position that the property, deeded to petitioners in 1927 subject to the indebtedness which they assumed and later paid, was thereafter actually owned by them subject to the encumbrances, of course; that the transfer of the property to the creditor in 1933 was a transaction constituting either a sale or an exchange of all their right, title and interest in the property in consideration for cash and the amount of their outstanding note obligation; and that therefore the loss suffered upon disposal of the property, which had been held by petitioners for more than two years, constituted a statutory capital loss within the meaning of Section 101 (c) (2), (6) and (8) of the Revenue Act of 1932, *supra.*

The amount or deductibility of the loss is not in issue. (Br. 11.) The sole question is whether the loss should be treated as ordinary or capital. We submit that under the facts herein it is clearly a statutory capital loss and deductible only as such. This is true for the reasons that the property was deeded to petitioners in 1927 for $105,000; they paid approximately $67,000 toward the purchase price before disposing of it in 1933; they claimed and were allowed as deductions on their tax returns approximately $13,000 depreciation of improve-

ments on the property during their six years of tenure; they held it for more than two years, whereupon it became a statutory "capital asset" (Section 101 (c) (8), Revenue Act of 1932, *supra*); and they sold it in 1932 at a loss, having conveyed all their right, title and interest therein for the consideration of cash and the note obligation outstanding against it, which necessarily resulted in a statutory "capital loss" (Section 101 (c) (2), Revenue Act of 1932, *supra*).

The statute defines "capital assets" as property held by taxpayers for more than two years. Section 101 (c) (8), Revenue Act of 1932, *supra.* The Board held that the real estate in question was "held" by petitioners for more than two years, within the purview of the statute. (R. 36.) If petitioners purchased the property, it follows that they must have been the real owners. The stipulated facts show that they *purchased* it in 1927. (R. 33, 67.) Petitioners themselves state that they "purchased [the] real property", and that "This property was acquired by Will Rogers and his wife * * * as community property." (Br. 4–5.) "The property was deeded to them subject to the indebtedness which they assumed and paid." (R. 36.) Therefore they actually owned it even though they did not have clear, unencumbered title. Although they conveyed it in trust to secure payment of the note (R. 33, 68), this, of course, did not divest them of equitable title. Moreover, the application of the capital loss provisions of the statute

do not depend upon whether a taxpayer owns the property outright or has merely an equity or contract right in it, since it defines "capital assets" as property merely "held" by the taxpayer for more than two years. Any contrary interpretation would lead to absurd results such as, for example, where a mortgagor and mortgagee of property could each claim that they "held" less than the absolute title, and consequently that it did not constitute "capital assets" even though held for the statutory period of two years.

Moreover, whatever may be said of the character of their disposition of the property, the fact remains that petitioners voluntarily conveyed it to others in 1933 by "Grant Deed." (R. 81–82.) This implies a sale. Nowhere in their brief do they contend or suggest that they did not own the property from 1927 to 1933, or that it did not constitute capital assets within the meaning of the statute. Rather they admit (Br. 4–5) that they "purchased" and "acquired" it as community property in 1927. Therefore, it is not at all clear and petitioners do not explain how the property, constituting statutory capital assets because it was held by them for more than two years, could have been conveyed to others, at a loss without the loss having been a capital loss which, under the statute, "means deductible loss resulting from the sale or exchange of capital assets" (Section 101 (c) (2), *supra*). If the property was a statutory capital asset—and this is not denied— conveyed by deed to another at

a loss, therefore, it follows that the loss must necessarily be a capital loss under the provisions of the statute.

Petitioners contend, however, that the loss was not a "capital loss" for the reason that it did not result "from the sale or exchange of capital assets," as required by the terms of the statute (Section 101 (c) (2), *supra*); that, in the end, they had nothing more than they had in the beginning except a $54,000 loss (Br. 11–13); and that the transaction was therefore merely the satisfaction and payment of an existing debt (Br. 14–17) upon the culmination of which they received nothing of exchangeable value in return (Br. 17–18). If, therefore, they sold or exchanged the property and received something of exchangeable value in return, their argument necessarily falls. We submit that, under the facts herein, the transaction was clearly either a sale or an exchange upon the consummation of which they received adequate value in exchange.

Petitioners, in addition to admitting that they purchased and acquired the real estate as community property (Br. 4–5), also admit that "on April 21, 1933, they conveyed the property to the California Trust Company and the note in the amount of $38,000.00 was surrendered and cancelled," and they make reference to "the deed by which the conveyance was made * * *." (Br. 5.) They characterize this as a satisfaction and payment of the indebtedness existing between themselves and

the transferee of the property, and not a sale or exchange (Br. 16) even though they purchased and had title to the property, as heretofore shown. The deed (R. 81–82), however, clearly shows that they conveyed the property to the holder of the note in consideration of $10 and for the full satisfaction, cancellation and surrender of the note, and "that the consideration received by grantors is equal to the fair value of grantors interest in said land." This, in itself, concedes an adequate and valuable consideration. Contrary to petitioners' contention (Br. 17–18), therefore, this negatives the argument that they received nothing of exchangeable value in return in the transaction. (Apparently the value of the property had depreciated upon the inception of the depression, although this is not shown by the record). If, as petitioners contend (Br. 17–18), they received no consideration or exchangeable value in return, their loss would have been $92,055.25 (cost of the property less depreciation allowed) instead of only the claimed amount of $54,055.25, as the Board observed (R. 38). Moreover, their release from liability through the surrender and cancellation of the note was a valuable consideration for the sale. *Ferguson* v. *Larsen,* 139 Cal. App. 133, 33 Pac. (2d) 1061; *Merchants State Bank* v. *Chicago, B. & Q. R. Co.,* 245 Ill. App. 211; *Bradley & Co.* v. *Klingman Implement Co.,* 79 Nebr. 144; *Rachman* v. *Clapp,* 50 Nebr. 648; *Billings* v. *Warren,* 21 Tex. Civ. App. 77. There was, therefore, a contract upon a valuable consid-

eration between two or more persons for the transfer of property (cf. *Radebaugh* v. *Scanlan,* 41 Ind. App. 109) which, under the ordinary meaning of the words of the statute, constitutes a valid sale. Moreover, it is clear, as the Board points out (R. 42), that if petitioners had conveyed the property for $38,000 cash and paid the note with the money, they would thereby clearly have made a sale, and the situation is not changed where they conveyed their property directly to the creditor in satisfaction of their indebtedness. Cf. *United States* v. *Hendler,* 303 U. S. 564.

From the foregoing it cannot be gainsaid that we have all the elements of a valid sale—mutual agreement, competent parties, a valuable money consideration, and a transfer of title. *Iowa* v. *McFarland,* 110 U. S. 471, 478; *United States* v. *Benedict,* 280 Fed. 76, 80 (C. C. A. 2d); *Popp* v. *Munger,* 131 Okla. 282, 268 Pac. 1100, 1102; *City of Cannelton* v. *Collins,* 172 Ind. 193; *Gallus* v. *Elmer,* 193 Mass. 106; *Howard* v. *Harris,* 8 Allen (Mass.) 297, 299. It follows that the loss, suffered upon the sale or exchange of capital assets held by petitioners for more than two years, is necessarily a statutory capital loss and deductible only as such.

Moreover, there is no substantial difference between a sale and an exchange in that in either case title to the property is absolutely transferred and the same rules of law apply to the transaction whether the consideration upon the contract is money or by way of barter. *Hale* v. *Helvering,* 85

F. (2d) 819 (App. D. C.). Therefore the provisions of the statute are equally applicable in the event of a "sale or exchange of capital assets." Section 101 (c) (2), *supra.*

Finally, if the transaction constituted merely satisfaction and payment of their existing debt, as petitioners contend (Br. 16), that would in nowise entitle them to a deduction for the loss, either ordinary or capital, as the Board pointed out (R. 38). What they are claiming is a loss realized upon the disposition of property, admitted to be a statutory capital asset, and since the assets were sold or exchanged for a valuable consideration, the resulting loss may be deducted only as a statutory capital loss.

The cases relied on by petitioners are distinguishable or have no application to the facts herein. Thus, *Hale* v. *Helvering, supra,* relied upon principally by petitioners (Br. 14–16), is distinguished by the Board (R. 40–42). There, the taxpayer sold real property in 1925 for $60,000, transferred full title to the purchaser upon the payment of $20,000 cash and $40,000 in notes secured by first mortgage, reported the profit in his 1925 tax return, and paid the tax thereon. At maturity of the notes in 1927, the maker, although financially able, refused to pay, whereupon suit was instituted in 1929, but before judgment, a settlement was agreed upon in that year which resulted in a loss to the taxpayer of approximately $7,500. The Commissioner determined that it was not a capital loss, contending be-

fore the Board that it was allowable only as a bad debt deduction. The court held that it was not a capital loss for the reason that it did not result from a sale or exchange, stating (p. 822):

> the compromise with the maker, who was able to pay them, of promissory notes, for less than their face value, does not constitute a sale or exchange of capital assets entitling the taxpayer to a capital loss.

Thus, in that case, the taxpayer sold the property only later, after institution of suit, to compromise the sum still due on the notes at a greatly reduced amount. Apparently, it was in the nature of a consideration for settlement of the suit. The compromise of liability on a note is not a sale of the note, but that is not the situation herein. The court there held, therefore, that such a transaction was neither a sale nor an exchange, but merely the extinguishment of the liability on the notes. That is quite different from the situation in the instant cases, wherein the property was actually and voluntarily sold and conveyed to a third party for a valuable consideration (cancellation of the note) "equal to the fair value of grantors interest in said land." (R. 82.) In the former, there was a compromise of the contested obligation under the notes; in the latter, a voluntary sale or exchange of the property for a note at a loss, for the apparent reason that the property in question, purchased in 1927 during the time of higher prices, was sold after it had decreased in value.

Upon analysis, therefore, it does not seem so incredible, as stated by petitioners (Br. 15–16), that the loss suffered by the mortgagee, pursuant to a compromise under the peculiar facts in that case, should not be treated as a capital loss, whereas the loss suffered by the mortgagors in the present cases, pursuant to a voluntary sale or exchange for a valuable consideration, should be considered a capital loss. It is apparent that a compromise settlement between debtor and creditor, where the notes are merely paid off at less than the amount of the obligation, does not constitute a sale or exchange resulting in a "capital loss," as was held in the *Hale* case, any more than does the satisfaction and payment of a debt, under similar circumstances, between debtor and creditor, as stated by petitioners (Br. 16), or than does the payment at maturity of the face value of bonds purchased at a premium, as pointed out by the court in the *Hale* case, citing *Watson* v. *Commissioner,* 27 B. T. A. 463, also relied upon by petitioners (Br. 16).

Likewise, in *United States* v. *Fairbanks,* 95 F. (2d) 794 (C. C. A. 9th), relied on by petitioners (Br. 16), this Court, citing *Watson* v. *Commissioner, supra,* held that the redemption of bonds or other obligations—the mere payment thereof according to their terms—admittedly statutory capital assets, is in nowise a sale or exchange, and therefore could not result in capital gain or loss. The same is true, of course, of the increment realized upon the surrender of insurance and annuity

policies. *Hellman* v. *Commissioner,* 33 B. T. A. 901. Cf. also, *Braun* v. *Commissioner,* 29 B. T. A. 1161; *Brown* v. *Commissioner,* 36 B. T. A. 178, and *Felin* v. *Kyle,* 22 F. Supp. 556 (E. D. Pa.), all of which are relied upon by petitioners (Br. 16–17), and none of which involves a sale or exchange, and therefore obviously can have no bearing on the question in the instant cases.

In *Dallas T. & T. Warehouse Co.* v. *Commissioner,* 70 F. (2d) 95 (C. C. A. 5th), the insolvent taxpayer in 1928, owing its lessor approximately $108,000 on a warehouse it had leased for 20 years at $7,000 per month, conveyed certain property in which it had an equity of approximately $17,000 to the lessor who later cancelled the balance of the debt, charging it off as worthless. The court there held that the taxpayer realized no gain or profit since it received nothing of exchangeable value in return, whereas in the instant cases, petitioners admittedly received a consideration equal to the fair value of their interest in the property sold. (R. 82.)

In *Commonwealth, Inc.* v. *Commissioner,* 36 B. T. A. 850, relied upon by petitioners as inconsistent with the instant decisions (Br. 19), the owner of the real property, subject to a mortgage, deeded the property to the mortgagee, *without consideration,* and thereby sustained a loss held to have been ordinary and not capital. No comment thereon is necessary further than that there, as the Board points

out (R. 43–44), there was no consideration for the transfer of the title to the mortgagee and consequently no sale or exchange, whereas herein petitioners received a consideration of $10 cash and "full satisfaction of all obligations [the $38,000 note] secured by the deed of trust."

In *Hammel* v. *Commissioner*, 36 B. T. A. 1331 (memorandum opinion), *Rust* v. *Commissioner*, 38 B. T. A., No. 115, and *Warfield* v. *Commissioner*, 38 B. T. A., No. 114, also stated by petitioners to be similarly inconsistent with the instant decisions (Br. 19–20), the taxpayers were the mortgagors of property which was foreclosed and sold, and the Board held that the losses suffered were ordinary as distinguished from capital. In none of those cases, however, can it be said that an enforced sale, upon foreclosure proceedings resulting in an involuntary loss, is in anywise like or comparable with the voluntary sale or exchange herein for a consideration equal in value to the taxpayers' interest in the property sold. Those cases, unlike the instant cases, involved involuntary conveyances without a valuable consideration flowing to the taxpayers, the mortgagors, and are more in line with the *Commonwealth, Inc. case*, *supra*, wherein the property was conveyed without consideration. Petitioners, rather than submit to foreclosure proceedings, voluntarily sold their property (apparently greatly depreciated in value since purchased) at a loss for a consideration admittedly only

equivalent in value to the fair value of their outstanding note.

Thus, it is apparent that the Board's decisions in the instant cases are not in conflict with any of its prior decisions and, as petitioners state (Br. 11), the issue involved herein is one which has never been passed upon by the courts, or by the Board except in the instant decisions. Moreover, from the foregoing it is apparent that petitioners are in error in stating (Br. 11) that the underlying principle, disclosed by the facts herein, has been so decided.

In view of the foregoing, it is submitted that the marital community loss sustained by petitioners upon the sale or exchange of their property in the taxable year is a statutory capital loss, and not an ordinary loss, within the meaning of the pertinent provisions of the statute.

CONCLUSION

The decisions of the Board of Tax Appeals are correct and in accordance with law, and should therefore be affirmed.

Respectfully submitted.

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January 1939.

U. S. GOVERNMENT PRINTING OFFICE: 1938

No. 9007

In the United States Circuit Court of Appeals

For the Ninth Circuit.

BETTY ROGERS,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent,

and

BETTY ROGERS, O. N. BEASLEY, OSCAR LAWLER, JAMES K. BLAKE, Executors of the Estate of Will Rogers, Deceased,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONERS' REPLY BRIEF.

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No. 9007

In the United States Circuit Court of Appeals

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vs.

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Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONERS' REPLY BRIEF.

An examination of the brief for respondent in the case at bar discloses that respondent is compelled to place emphasis on form rather than substance to sustain his position with regard to the taxing effect of the events which took place in the instant case.

This attitude and emphasis in the interpretation of the federal taxing statutes has been recently condemned by the United States Supreme Court in an unanimous opinion in

the case of *Lyeth v. Hoey*, ... U. S. ...., 59 Sup. Ct. 155, 83 L. Ed. (Adv. Ops.) 176 (December 5, 1938).

In this case the question presented was whether property received by the petitioner from the estate of a decedent in a compromise of his claim as an heir was taxable as income. It appeared that petitioner was the grandson of the decedent who died in 1931, a resident of Massachusetts leaving several heirs, among whom was petitioner. By her will decedent gave certain small legacies to her heirs and bequeathed the residuary estate, amounting to $3,000,000 to an Endowment Trust, the income from which was to be paid to another trust created for certain religious purposes. When the will was offered for probate in Massachusetts objection was made by the heirs on the ground of lack of testamentary capacity and undue influence. Eventually a compromise agreement was entered into by the heirs, legatees, devisees and executors providing that certain distributions from the residuary estate were to be made to the heirs. It was petitioner's distributive share under the compromise agreement valued by the Commissioner at some $141,000 which was the subject of the litigation, the Commissioner contending that this sum constituted income to the petitioner in the year it was received, since the law of Massachusetts provided that the rights of parties receiving property under compromise agreements in will contests were contractual and not testamentary. In holding that the sum thus received by the petitioner did not constitute income but rather a sum received by inheritance within the meaning of the Revenue Act, the Court stated:

> "There is no question that petitioner obtained that portion, upon the value of which he is sought to be taxed, because of his standing as an heir and

of his claim in that capacity. It does not seem to be questioned that if the contest had been fought to a finish and petitioner had succeeded, the property which he would have received would have been exempt under the federal act. Nor is it questioned that if in any appropriate proceeding, instituted by him as heir, he had recovered judgment for a part of the estate, that part would have been acquired by inheritance within the meaning of the act. *We think that the distinction sought to be made between acquisition through such a judgment and acquisition by a compromise agreement in lieu of such a judgment is too formal to be sound, as it disregards the substance of the statutory exemption.* It does so, because it disregards the heirship which underlay the compromise, the status which commanded that agreement and was recognized by it." (Italics added.)

In the instant case, as in *Lyeth v. Hoey, supra,* the respondent seeks to disregard the substance of the transactions. Respondent regards as important the fact that as the method of relinquishing their equity, Mr. and Mrs. Rogers employed the vehicle of a "Grand Deed" which, as do practically all the grant deeds that are or were ever written, commences by reciting a consideration of "Ten and no/100 dollars" (Resp. Br. pp. 8, 13, 15, 21). Although petitioners are unable to perceive any importance in the fact that the deed makes such a recital. since respondent appears to rest his case in such large measure on this fact, it is believed that it should be pointed out:

First, that it has never before been contended by any of the parties to these proceedings that Mr. and Mrs. Rogers received $10.00 or any other sum of money for this conveyance and respondent himself in computing the alleged deficiency has not reflected the payment of any

such sum; secondly, that in assuming that such sum of money was either paid or received merely from the fact of the recital in the deed attached as an exhibit to the stipulation in this case, respondent is reading into the stipulation, a fact which is not stipulated either by content or inference in the stipulation itself, since the amount of loss agreed upon by the parties in paragraph VIII of the stipulation did not include any cash consideration paid by the deed [Tr. 70].

Reverting to the substance of the transactions in the instant case, it appears that Mr. and Mrs. Rogers purchased the property in question paying a portion of the purchase price in cash and for the remainder thereof assuming an already existing indebtedness and conveying the property under trust deed in favor of the seller. The assumed indebtedness was paid and the indebtedness for which the trust deed was given had become due. Suit had been threatened and rather than suffering foreclosure proceedings, Mr. and Mrs. Rogers relinquished their equity in the property. It was natural that the vehicle of a grant deed should be employed in doing so since by such a deed, title records could be kept more clear and free from doubt. There would be no question under the status of the law as the decisions of the Board of Tax Appeals now stand that had Mr. and Mrs. Rogers allowed foreclosure proceedings to take place, the loss which they suffered would have been an ordinary loss rather than a capital loss. (*Hammel v. Commissioner*, 36 B. T. A. 1331, and other foreclosure cases cited in petitioner's opening brief.)

It is submitted that respondent has not successfully distinguished the situation in the instant case from the cases cited by petitioners in their opening brief, namely,

Hammel v. Commissioner, 36 B. T. A. 1331; *Rust v. Commissioner*, 38 B. T. A. 115, and *Warfield v. Commissioner*, 38 B. T. A. 114. The ground upon which respondent attempts to distinguish these cases is that they involve "involuntary conveyance without a valuable consideration flowing to the taxpayers." Certainly in substance the consideration for such conveyances was exactly the same as the consideration in the instant case, namely, payment of a debt.

It is believed that the same reasoning which the Supreme Court of the United States has applied in the case of *Lyeth v. Hoey*, *supra*, to the effect that if the suit had been prosecuted to judgment the contention of the respondent could not be maintained, should be applicable in the instant case. It is a tenet of the law, so old and so well known as to be a legal maxim, that—"the law neither does nor requires idle acts". (California Civil Code, Section 3532.) Certainly it would have been an idle act for Mr. and Mrs. Rogers to have suffered foreclosure proceedings when all that would have been accomplished by such foreclosure proceedings is exactly what was accomplished in the transactions in the instant case.

Respondent seeks to distinguish cases cited by the petitioners in their opening brief, namely, *Watson v. Commissioner*, 27 B. T. A. 463, and *United States v. Fairbanks*, 95 Fed. (2d) 794 (C. C. A. 9, 1938), merely by stating that no sale or exchange occurred in these cases. Petitioners, of course, cited these cases on the ground that the facts were analogous to the instant case and that the Courts in the cases did decide that no sale or exchange had therein occurred. Petitioners do not feel that the authority of these cases has been satisfactorily disputed

by merely stating the conclusion of the Courts in those cases, namely, that there was not a sale or exchange, without showing why the same conclusion should not be reached in the case at bar. Certainly what happens when bonds are redeemed is that sums of money are paid to the bondholders in return for the surrender and cancellation of the bond instrument which is the evidence of liability of the obligor on the bond in the same fashion as the note is the evidence of liability of the obligor on the note. In other words, the payment of a debt does not give rise to a capital loss.

For the reason, therefore, that the substance of the transactions in the instant case discloses that what actually happened was that the taxpayers relinquished their equity to pay off the debt still due on the purchase of the property and for the additional reason that the United States Supreme Court has recently stated that the substance of a transaction should control its effect for taxing purposes rather than the form and for the additional reason that respondent has failed to distinguish satisfactorily analogous cases in which the loss has been declared by the Courts to be ordinary rather than capital, and for the additional reasons set forth in petitioners' opening brief, petitioners respectfully submit that the decisions of the Board of Tax Appeals should be reversed.

Respectfully submitted,

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No. 9015

United States

Circuit Court of Appeals

For the Ninth Circuit.

PACIFIC STATES SAVINGS & LOAN CORPORATION, a corporation, substituted for Reconstruction Finance Corporation, a corporation,

Appellant,

vs.

LEO F. SCHMITT, as Receiver of BANK OF NEVADA SAVINGS & TRUST COMPANY, CARSON VALLEY BANK, TONOPAH BANKING CORPORATION and VIRGINIA CITY BANK,

Appellees.

Transcript of Record

Upon Appeal from the District Court of the United States for the District of Nevada.

PARKER PRINTING COMPANY, 545 SANSOME STREET, SAN FRANCISCO

No. 9015

United States
Circuit Court of Appeals
For the Ninth Circuit.

PACIFIC STATES SAVINGS & LOAN CORPORATION, a corporation, substituted for Reconstruction Finance Corporation, a corporation,

Appellant,

vs.

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Upon Appeal from the District Court of the United States for the District of Nevada.

PARKER PRINTING COMPANY, 545 SANSOME STREET, SAN FRANCISCO

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*Page numbering appearing at the foot of page of original certified Transcript of Record.

In the District Court of the United States of America, in and for the District of Nevada.

In Equity

No. H-117

RECONSTRUCTION FINANCE CORPORATION, a corporation,

Plaintiff,

vs.

LEO F. SCHMITT, as Receiver of BANK OF NEVADA SAVINGS & TRUST COMPANY, CARSON VALLEY BANK, TONOPAH BANKING CORPORATION and VIRGINIA CITY BANK,

Defendants.

BILL OF COMPLAINT FOR INJUNCTION AND DECLARATORY RELIEF

Plaintiff complains of defendants and for cause of action alleges:

I.

That at all of the times herein mentioned, Reconstruction Finance Corporation was and now is a corporation organized and existing under and by virtue of the laws of the United States of America.

II.

That at all of the times herein mentioned The [2] Reno National Bank was and now is a national banking association, organized and existing under

and by virtue of the banking laws of the United States of America, and having its principal office and place of business in the City of Reno, State of Nevada.

III.

That at all of the times herein mentioned, each of the following were and now are corporations organized and existing under and by virtue of the laws of the State of Nevada:

Bank of Nevada Savings & Trust Company
Carson Valley Bank
Tonopah Banking Corporation
Virginia City Bank
Humboldt-Lovelock Irrigation Light & Power Co.
Old Channel Ditch Company
Union Canal Ditch Company
Young Ditch Company

IV.

At all of the times herein mentioned, John G. Taylor, Inc. was and now is a corporation organized under the laws of the State of Wyoming.

V.

That after due investigation of the financial condition of The Reno National Bank, the Comptroller of the Currency of the United States of America found said bank to be insolvent, and on or about the 9th day of December, 1932, in accordance with the statutes of the United States of America in such cases made and provided, appointed Walter J.

Tobin Receiver of said bank and of the assets thereof.

That thereafter, and on the 12th day of December, 1932, said Walter J. Tobin duly qualified as such Receiver [3] and ever since has been and now is the Receiver of said The Reno National Bank.

VI.

That thereafter such proceedings were duly had and taken in and by the District Court of the State of Nevada in and for the First Judicial District, that by orders and judgments duly given and made by said court on the 28th day of February, 1934, Leo F. Schmitt was appointed Receiver of each of the following banking corporations:

Bank of Nevada Savings & Trust Company
Carson Valley Bank
Tonopah Banking Corporation
Virginia City Bank

That immediately thereafter said Leo F. Schmitt duly qualified as such Receiver and ever since has been and now is the duly appointed, qualified and acting Receiver of said corporations, and of the business, property and assets of each thereof.

VII.

That on the ninth day of June, 1930, and for many years prior thereto, John G. Taylor was the owner of the following number of shares of the capital stock of the respective companies indicated:

37,273 shares Class A stock of Humboldt-Lovelock Irrigation Light & Power Company

2,857 shares of Young Ditch Company
150 shares of Union Canal Ditch Company [4]
1,121-1/3 Shares of Old Channel Ditch Company

That said shares of stock are hereinafter referred to as "said water stock" and said companies are hereinafter referred to as "said water companies".

VIII.

That by virtue of his ownership of certain lands situate in the Lovelock Valley, more particularly described in the schedule hereunto annexed and marked Exhibit A, the ownership of said water stock vested in the said John G. Taylor certain rights (hereinafter referred to as "water rights") to receive from the respective water companies certain quantities of water for use upon said lands, and/or to the use of the ditches and other facilities of the respective water companies for the conveyance of water to said lands.

IX.

That said water rights, as well as said water stock, now are and at all times have been connected with, belonging, appurtenant or incident to the said lands referred to in the next preceding paragraph hereof, or used in connection therewith, and of such nature as to pass with a conveyance of said lands. That without said water rights said lands are arid and practically without value.

X.

That on the ninth day of June, 1930, said John G. Taylor made, executed and delivered to John G. Taylor, Inc., a corporation organized and existing under and by virtue of the laws of the State of Wyoming, a deed conveying to said John G. Taylor, Inc. all property, real, personal and mixed, then owned by the said John G. Taylor, [5] within the State of Nevada, save and except property standing in his name and located within the corporate limits of the City of Lovelock, State of Nevada. That said deed was duly acknowledged so as to entitle it to be recorded and that the same was duly recorded in the offices of the County Recorder of the Counties of Pershing, Humboldt and Elko, State of Nevada, on or about the 12th day of June, 1930. That no part of the lands referred to in Paragraph VIII hereof, or of said water stock or said water rights was or is located within the corporate limits of the City of Lovelock, State of Nevada. That by virtue of said deed all of said lands, water stock and water rights passed to and became vested in the said John G. Taylor, Inc.

XI.

That at all times since the execution and delivery of said deed, John G. Taylor has been president of John G. Taylor, Inc. and owner of all of its issued and outstanding capital stock excepting only directors' qualifying shares.

XII.

That on the 12th day of March, 1932, said John G. Taylor, Inc. made, executed and delivered to The Reno National Bank its promissory note payable on demand to the order of The Reno National Bank, in the principal amount of $700,000.00. That simultaneously with the execution and delivery of said promissory note, said John G. Taylor, Inc., for the purpose of securing the payment of said promissory note, made, executed and delivered to The Reno National Bank a real estate mortgage and a chattel mortgage. That each of said mortgages was duly acknowledged by the said John G. Taylor, Inc. [6] so as to entitle it to be recorded and each of said mortgages was in fact recorded in the office of the County Recorders of the Counties of Humboldt, Pershing and Elko, State of Nevada. That thereafter, an error having been discovered in said real estate mortgage, the said John G. Taylor, Inc. on or about the 27th day of April, 1932, for the purpose of securing the said promissory note, made, executed and delivered to The Reno National Bank a new real estate mortgage dated as of the 12th day of March, 1932, which said real estate mortgage was duly acknowledged so as to entitle it to be recorded, and the same was duly recorded in the offices of the County Recorders of the Counties of Humboldt, Pershing and Elko, State of Nevada.

XIII.

That in and by each of the real estate mortgages mentioned in the next preceding Paragraph hereof,

the said John G. Taylor, Inc. mortgaged unto The Reno National Bank all of the lands referred to in Paragraph VIII hereof, as well as all other lands and interests in lands which the said John G. Taylor, Inc. then owned, together with all water, water rights, water applications, water permits or privileges connected with, belonging, appurtenant or incident to the lands covered by said mortgage or used in connection with all or any part of said premises or used or usable in connection therewith, and all dams, reservoirs and ditches, canals and other works for storage or carrying [7] of water then owned by the mortgagor or in which the mortgagor then had or might thereafter acquire any interest, and all applications then pending in the office of the State Engineer of the State of Nevada for any and all water to be used upon any part or portion of said lands, or used in connection therewith.

That by virtue of said real estate mortgages said water stock and water rights were hypothecated for the payment of said promissory note in the principal amount of $700,000.00.

XIV.

That at the time of the execution and delivery of the aforesaid promissory note in the principal amount of $700,000.00, share certificates evidencing all of said water stock, duly endorsed for transfer, were or had been delivered to and were held by The Reno National Bank as further evidence of the hypothecation of said water stock and water rights

for the payment of the indebtedness evidenced by said promissory note.

XV.

That prior to the fifth day of May, 1932, The Reno National Bank endorsed, transferred and delivered the aforesaid promissory note of John G. Taylor, Inc. in the principal amount of $700.000.00, to Reconstruction Finance Corporation, as collateral security for a loan far in excess of the amount of said promissory note. That Reconstruction Finance Corporation ever since has been the owner and holder of said promissory note and of all liens securing the same. That no part of the principal or interest of said promissory note of John G. [8] Taylor, Inc. has been paid, save and except that $70,779.27 has been paid on account of the principal thereof, and that interest has been paid thereon to June 30, 1932. That there remains unpaid on account of the indebtedness for which said promissory note was endorsed, transferred and delivered to this defendant as collateral security, an amount far in excess of the principal amount remaining unpaid on said promissory note.

XVI.

That at all times prior to the 1st day of November, 1932, the businesses of both the Bank of Nevada Savings & Trust Company and The Reno National Bank were conducted in the same banking rooms. That the directors of both banks were the same and that the principal officers of both banks

were the same. That the entire issued and outstanding capital stock of the Bank of Nevada Savings & Trust Company was held by and vested in the directors of The Reno National Bank in trust for the shareholders of The Reno National Bank. That both banks were conducted as a single banking unit. That after the aforesaid promissory note in the principal amount of $700,000.00 was endorsed, transferred and delivered to the Reconstruction Finance Corporation, the certificates evidencing said water stock, by some means unknown to Reconstruction Finance Corporation, found their way into the possession of the Bank of Nevada Savings & Trust Company, and at the time said Leo F. Schmitt was appointed Receiver of the Bank of Nevada Savings & Trust Company, were delivered to the said Leo F. Schmitt. That said Leo F. Schmitt, as Receiver of the Bank of Nevada Savings & Trust Company, by virtue of his possession of said certi- [9] ficates, asserts a lien on said water stock for the payment of three promissory notes in the aggregate principal amount of $32,500.00, made, executed and delivered to the Bank of Nevada Savings & Trust Company by John G. Taylor, Inc. subsequent to the endorsement, transfer and delivery to the Reconstruction Finance Corporation of the said promissory note of John G. Taylor, Inc. in the principal sum of $700,000.00. That said Leo F. Schmitt, in his capacity as Receiver of Tonopah Banking Corporation, Carson Valley Bank and Virginia City Bank, claims a lien as attaching creditor of John G.

Taylor, Inc. and/or John G. Taylor for an indebtedness in the aggregate principal amount of $24,000.00.

XVII.

That in applying for the loan made by the Reconstruction Finance Corporation to The Reno National Bank, The Reno National Bank represented to the plaintiff that the aforesaid promissory note of John G. Taylor, Inc. in the principal amount of $700,000.00 was secured by the hypothecation of the lands referred to in Paragraph VIII hereof, as enhanced in value by rights to the use of dams, reservoirs, ditches, canals and other works for the storage and carrying of water, which said rights plaintiff alleges to be the same as the water rights referred to in Paragraph VIII. That the Reconstruction Finance Corporation would not have made said loan to The Reno National Bank in the amount in which said loan was made, if said water rights and water stock were not to be hypothecated with the lands referred to in Paragraph VIII hereof.

XVIII.

That the Bank of Nevada Savings & Trust Company, at the time the aforesaid promissory note of John G. Taylor, Inc. in the principal amount of $700,000.00 was endorsed, [10] transferred and delivered to the Reconstruction Finance Corporation, had full knowledge of the facts alleged in Paragraphs VII, VIII, IX, X, XI, XII, XIII, XIV, XV, XVI and XVII.

XIX.

That the Tonopah Banking Corporation, Carson Valley Bank and Virginia City Bank, and each of them, at the time the aforesaid promissory note of John G. Taylor, Inc. in the principal amount of $700,000.00 was endorsed, transferred and delivered to the Reconstruction Finance Corporation, had full knowledge of the facts alleged in Paragraphs VII, VIII, IX, X, XI, XII, XIII, XIV, XV, XVI and XVII.

XX.

That said Leo F. Schmitt threatens to transfer, and unless enjoined by the order of this Honorable Court, will transfer the certificates in his possession evidencing said water stock to third persons, to the irreparable injury of Reconstruction Finance Corporation. That said Reconstruction Finance Corporation has no adequate remedy at law.

XXI.

That prior to the commencement of this action plaintiff obtained leave of the District Court of the State of Nevada for the First Judicial District to commence and prosecute this action.

Wherefore, plaintiff prays that the court enjoin the said Leo F. Schmitt, during the pendency of this action, from transferring or parting with possession of said certi- [11] ficates evidencing said water stock, and that the court make and enter its judgment declaring that said water stock and/or water rights are subject to and covered by the lien

of the aforesaid real estate mortgage and/or to the lien of the plaintiff for the payment of the aforesaid promissory note of John G. Taylor, Inc. in the principal amount of $700,000.00, and that the rights and interests, if any, of the defendant in and to said water stock and/or water rights, if any, are junior and subordinate to the rights and interests and lien of the plaintiff, and generally declaring the rights of the plaintiff and the defendant in reference to said water rights and water stock in accordance with the provisions of section 400 of Title 28 of the United States Code; and awarding the plaintiff its costs of suit incurred herein and such other and further relief as may to the court seem meet and just in the premises.

RECONSTRUCTION FINANCE CORPORATION,
By ALLARD A. CALKINS
Manager, San Francisco
Loan Agency.

WILSON McCARTHY
BROBECK, PHLEGER & HARRISON
Attorneys for Plaintiff. [12]

State of Nevada
County of Washoe.—ss.

Allard A. Calkins, being first duly sworn, deposes and says:

That he is the Manager of the San Francisco Loan Agency of the Reconstruction Finance Corporation, the plaintiff in the above-entitled action,

and that he makes this verification for and on behalf of said plaintiff corporation; that he has read the foregoing bill of complaint and knows the contents thereof, and that the same is true according to the best of his knowledge, information and belief.

ALLARD A. CALKINS

Subscribed and sworn to before me this 1st day of November, 1934.

[Seal] H. S. GORMAN

Notary Public in and for the County of Washoe, State of Nevada.

My commission expires Oct. 6, 1937. [13]

EXHIBIT "A"

All those certain pieces or parcels of land, situate in the State of Nevada described as follows, to wit:

In Township 27 North, Range 31 East,
M. D. B. & M.

Section 3: All of said section.

Section 4: Fractional part of the east half of said section.

Section 10: Fractional part of the north half, and that portion of the southwest quarter of said section lying north of the Old Channel Ditch.

Section 20: The south half of the southeast quarter.

Section 21: The east half of the northwest quarter; the east half of the southeast quarter of the southwest quarter; that portion of the east half of said section lying on the west side of what is known as the Old River Channel.

Section 22: The N½ of the SW¼; the SW¼ of the SW¼, and 17 acres, more or less, in the SE¼ of the SW¼ of said Section.

Section 28: The fractional E½ of the NE¼ and that portion of the NW¼ of said section lying on the west side of the Old River Channel.

Section 29: All of Section.

Section 30: The E½ of the SE¼.

Section 31: The E½.

Section 32: Fractional part of the S½ of the NW¼ and fractional part of the N½ of the SW¼.

In Township 28 North, Range 31 East,
M. D. B. & M.

Section 26: The E½ of the E½ of said section.

Section 33: The E½ of the NE¼ and the SE¼.

Section 34: All of said section.

In Township 28 North. Range 32 East,
M. D. B. & M.

Section 2: The S½ of the SW¼.

Section 16: The SE¼ of the NE¼.

In Township 30 North, Range 33 East,
M. D. B. & M.

Section 3: The NW¼ of the NW¼.

Section 18: The SE¼ of the NE¼ and the NE¼ of the SE¼.

Section 21: The S½.

Section 28: All of said section.

Section 30: The west half of the east half.

[Endorsed]: Filed Nov. 1st, 1934. [14]

[Title of District Court and Cause.]

DEMURRER

Comes Now defendant above named, and demurring to Plaintiff's complaint on file herein, for ground of demurrer alleges:

I.

That said complaint does not state facts sufficient to constitute a cause of action against said defendant.

Wherefore, said defendant prays that said plaintiff take nothing by its said action, and that said defendant be hence dismissed, with costs.

PLATT & SINAI

Attorneys for Defendant. [15]

I Hereby Certify that I am one of the attorneys for the above named defendant, and that in my opinion the foregoing demurrer is well founded in point of law.

JOHN S. SINAI

Attorneys for Defendant.

[Endorsed]: Filed Nov. 19, 1934. [16]

[Title of District Court and Cause.]

MINUTES OF COURT JUNE 8, 1936.

This being the time heretofore fixed for the hearing on defendant's demurrer, and the same coming on regularly this day, Messrs. Brobeck, Phleger & Harrison, of counsel, appearing by Mr. A. M.

Dreyer, for the plaintiff; and Samuel Platt, Esq., of counsel, appearing for the defendant. Counsel stipulate, for the purposes of the record, that this demurrer may be deemed a motion to dismiss. Following argument by counsel for the respective parties the matter is submitted to the Court. Mr. Platt now files memorandum of points and authorities and Mr. Dreyer states he, likewise, will file memorandum of points and authorities. It Is Ordered that the motion to dismiss herein be, and the same hereby is, overruled and the defendant allowed twenty days from and after this date within which to file answer. [17]

[Title of District Court and Cause.]

DEFENDANTS' ANSWER.

Now Come the above named defendants, through their attorneys, Messrs. Platt & Sinai, and by leave of Court first had and obtained, file this their Answer herein, and admit, deny and aver, as follows:

I.

Defendants admit the allegations of paragraphs I, II, III, IV, V, VI and VII of said Bill of Complaint. [18]

II.

Defendants deny that by virtue of the ownership of John G. Taylor of certain lands situated in the Lovelock Valley, more particularly described in

Exhibit A of said Bill of Complaint, that the ownership of said water stock, or any thereof, vested in the said John G. Taylor, certain, or any rights, (referred to in said Bill of Complaint as "water rights") to receive from the respective, or any, water company or companies, certain or any quantity or quantities of water for use upon, said lands, or any thereof, and/or to the use of the ditches, or any thereof, or other facilities of the respective water companies, or any thereof, for the conveyance of water to the said lands, or any thereof.

III.

Defendants deny that said water rights, or any thereof, as well as said water stock, or any thereof, or either or any, now are or ever were or at all times or at any time or times, have been connected with, belonging, appurtenant or incident, or any or either, to the said lands, or any thereof, referred to in said Bill of Complaint, or used in connection therewith; deny that said water rights, or said water stock, or any or either, or any part or portion thereof, was or ever has been of such nature as to pass with the conveyance of said lands. As to whether without said water rights, as referred to in paragraphs VIII and IX of said Bill of Complaint, said lands are arid and practically without value, these defendants have not sufficient information wherewith to express a belief, and, therefore, upon information and belief, deny the same. [19]

IV.

Defendants admit the allegations of paragraph X of said Bill of Complaint, with the exception of the last sentence thereof, and defendants admit that by virtue of said deed all of said lands passed to and became vested in the said John G. Taylor, Inc., but deny that any part or portion of said water stock or water rights passed to and became vested in the said John G. Taylor, Inc.

V.

As to whether at all times since the execution and delivery of said deed John G. Taylor has been President of John G. Taylor, Inc., and owner of all of its issued and outstanding stock excepting only directors' qualifying shares, these defendants have not sufficient knowledge whereby to express a belief, and therefore, upon information and belief, deny the same and place plaintiff on strict proof thereof.

VI.

Defendants admit the allegations of paragraph XII of said Bill of Complaint.

VII.

Defendants admit the allegations of the first paragraph of paragraph XIII of said Bill of Complaint; but in this connection aver that "all water, water rights, water applications, water permits or privileges connected with, belonging, appurtenant or incident to the lands covered by said mortgage, or used in connection with all or any part of said

premises, or used or usable in connection therewith, and all dams, [20] reservoirs and ditches, canals and other works for storage or carrying of water then owned by the mortgagor, or in which the mortgagor then had or might thereafter acquire any interest", as set out in said mortgage did not include, nor was never intended to include, any of the stock held by John G. Taylor individually in the various water companies and corporations set out in plaintiff's Bill of Complaint, nor did not create or establish, and was never intended to create or establish any lien or encumbrance of any kind, character or nature upon such stock, or any part or portion thereof.

Defendants deny that by virtue of said real estate mortgages, or any or either thereof, said, or any, water stock or water rights, were hypothecated for the payment of said promissory note in the principal amount of $700,000, or in any other principal amount. Defendants allege that none of said water stock and water rights by virtue of said real estate mortgages, or either thereof, or at all, were hypothecated, by way of security, or collateral, or otherwise, to the Reno National Bank, to secure the payment of the promissory note referred to in paragraph XII of plaintiff's Bill of Complaint.

Defendants deny that at the time of the execution and delivery of the said promissory note in the principal amount of $700,000, or at any other time, share certificates, or any certificate or certificates evidencing all or any part or portion of said water

stock, duly endorsed for transfer, or endorsed at all, were or ever had been delivered to or were or were or ever have been held, by the Reno National Bank as further, or any evidence of the hypothecation of said water stock or water rights, or either, for the payment of the indebtedness evidenced by said promissory note. [21]

VIII.

As to the allegations of paragraph XV of plaintiff's Bill of Complaint. these defendants have not sufficient knowledge whereby to express a belief, and, therefore, upon information and belief, deny the same and generally and specifically each and every part and portion and averment thereof, and place plaintiff on strict proof thereof.

IX.

Defendants admit that at all times prior to the 1st day of November, 1932, the businesses of both the Bank of Nevada Savings & Trust Company and the Reno National Bank were conducted in the same banking rooms. Defendants admit that the Directors of both banks were the same and that the principal offices of both banks were the same. Defendants deny that the entire outstanding and issued capital stock of the Bank of Nevada Savings & Trust Company were held by and vested in the Directors of the Reno National Bank in trust for the shareholders of the Reno National Bank. Defendants deny that both banks were conducted as a single unit; and in this connection defendants al-

lege that since the organization of each of said banks, and ever since, the Reno National Bank was a Federal Bank organized under the laws of the United States of America, and that the Bank of Nevada Savings & Trust Company was a state bank organized under and by virtue of the laws of the State of Nevada; that each of said banks was a separate and distinct corporation one from the other, and during all of the times that each was open for the conduct of business, each of said banks held itself out to the public, patrons, deposit- [22] ors and others with whom it transacted business, as a separate and distinct banking institution one from the other, and so conducted its business with patrons, depositors and persons with whom it dealt. That as to whether after the promissory note in the principal amount of $700,000 was endorsed, transferred and delivered to the Reconstruction Finance Corporation, the certificates evidencing said water stock found their way into the possession of the Bank of Nevada Savings & Trust Company by some means unknown to Reconstruction Finance Corporation, these defendant have no definite knowledge whereby to express a belief, but upon information and belief, deny the same, and in this connection defendants aver that the share certificates of so-called water stock, referred to in said Bill of Complaint, came into the possession of the Bank of Nevada Savings & Trust Company through hypothecation and pledge by way of security for the payment of certain promissory notes duly exe-

cuted by John G. Taylor, Inc., and endorsed by John G. Taylor to Bank of Nevada Savings & Trust Company in the aggregate amount of $32,500 for money actually borrowed by the said John G. Taylor, Inc., from the said Bank of Nevada Savings & Trust Company. That the certificates of stock in the various water companies referred to in said bill of complaint, were duly endorsed, hypothecated, transferred and delivered to Bank of Nevada Savings & Trust Company by said John G. Taylor, and the said John G. Taylor entered into a collateral security agreement, in writing, with Bank of Nevada Savings & Trust Company, pledging said so-called water stock as collateral security for the payment of all of his then present indebtedness to Bank of Nevada Savings & Trust Company and of all of his future indebtedness to said bank. Defendants admit that [23] at the time said Leo F. Schmitt was appointed Receiver of the Bank of Nevada Savings & Trust Company, the certificates evidencing said water stock were delivered to the said Leo F. Schmitt. Defendants admit that said Leo F. Schmitt as Receiver of the Bank of Nevada Savings & Trust Company, by virtue of his possession of said certificates, asserts a lien on said water stock for the payment of three promissory notes in the aggregate principal amount of $32,500, made, executed and delivered to the Bank of Nevada Savings & Trust Company by John G. Taylor, Inc., subsequent to the endorsement, transfer and delivery to the Reconstruction Finance Corporation of the said

promissory note of John G. Taylor, Inc., in the principal sum of $700,000. Defendants admit that said Leo F. Schmitt in his capacity as Receiver of Tonopah Banking Corporation, Carson Valley Bank and Virginia City Bank, claims a lien as attaching creditor of John G. Taylor Inc., and/or John G. Taylor for an indebtedness in the aggregate principal amount of $24,000; but in this connection these defendants allege that the said Leo F. Schmitt as Receiver of the Bank of Nevada Savings & Trust Company, claims and asserts a lien upon said water stock for the indebtedness of John G. Taylor, Inc., to his said bank of Nevada Savings & Trust Company receivership, and in addition thereto an attachment lien for and on behalf of his other receivership trusts hereinabove referred to, upon such equities as may remain after his said first lien has been satisfied.

X.

As to whether in applying for the loan made by the Reconstruction Finance Corporation to the Reno National Bank, the Reno National Bank represented to the plaintiff that the [24] aforesaid promissory note of John G. Taylor, Inc., in the principal amount of $700,000, was secured by the hypothecation of the lands referred to in paragraph VIII of said Bill of Complaint, as enhanced in value by rights to the use of dams, reservoirs, ditches, canals and other works for the storage and carrying of water, these defendants have not suf-

ficient knowledge whereby to express a belief, and, therefore, upon information and belief, deny the same, and place plaintiff on strict proof thereof. Defendants deny that said rights above referred to, are the same as the water rights referred to in paragraph VIII of said Bill of Complaint. As to whether the Reconstruction Finance Corporation would not have made said loan to the Reno National Bank in the amount in which said loan was made, if said water rights and water stock were not to be hypohtecated to the lands referred to in paragraph VIII of plaintiff's complaint, these defendants have not sufficient knowledge whereby to express a belief, and, therefore, upon information and belief, deny the same. Defendants further aver that as to what the Reconstruction Finance Corporation would or would not have done, with respect to said loan, is entirely irrelevant and immaterial.

XI.

Defendants deny that the Bank of Nevada Savings & Trust Company at the time the aforesaid promissory note of John G. Taylor, Inc., in the principal amount of $700,000 was endorsed, transferred and delivered to the Reconstruction Finance Corporation, had full, or any knowledge of the facts alleged in the various paragraphs of paragraph XVIII of plaintiff's Bill of Complaint; and in this connection defendants [25] admit that the Bank of Nevada Savings & Trust Company had knowledge of the allegations of paragraphs VII and

XII of said Bill of Complaint, but had no knowledge of paragraphs VIII, IX, X, XI, XIV, XV, XVI and XVIII of said complaint.

XII.

Defendants deny that the Tonopah Banking Corporation Carson Valley Bank and Virginia City Bank, and each or any of them, at the time the aforesaid promissory note of John G. Taylor, Inc., in the principal amount of $700,000 was endorsed, transferred and delivered to the Reconstruction Finance Corporation, had full or any knowledge of the facts alleged in the various paragraphs set out in paragraph XIX of said Bill of Complaint; but in this connection defendants allege that said banking corporations had knowledge of the allegations of paragraphs VII and XII of said Bill of Complaint, but had no knowledge of paragraphs VIII, IX, X, XI, XIV, XV, XVI and XVIII of said complaint.

XIII.

Defendants deny that said Leo F. Schmitt threatens to transfer, and unless enjoined by the order of this honorable court, will transfer the certificates in his possession evidencing said water stock, to third persons, to the irreparable, or any, injury of Reconstruction Finance Corporation, or any one else. In this connection defendants allege that through agreement and stipulation with the plaintiff herein, said Leo F. Schmitt is holding said certificates of stock pending the termination of the within suit. [26]

And For a Further Affirmative Defense to Said Action, these defendants allege that the Bank of Nevada Savings & Trust Company loaned in cash John G. Taylor, Inc., the principal amount of $32,500, for which said corporation gave its duly executed three several promissory notes duly and regularly endorsed by John G. Taylor. That in the course of said transaction said John G. Taylor hypothecated, transferred and delivered, together with other security, certificates of stock in the various so-called water companies and corporations set out in plaintiff's Bill of Complaint and executed with the Bank of Nevada Savings & Trust Company, a collateral agreement pledging said certificates of water stock as security for the payment of the notes. That at the time of the execution of said collateral agreement, both the Bank of Nevada Savings & Trust Company and the Reno National Bank by virtue of their common Board of Directors and officials, had full knowledge that the Reno National Bank had loaned John G. Taylor, Inc., the sum of $700,000 and accepted a real estate mortgage referred to in said Bill of Complaint, but that also the Reno National Bank had full knowledge that the said John G. Taylor, Inc., had borrowed the sum of $32,500 from the Bank of Nevada Savings & Trust Company and had pledged, hypothecated and delivered said water stock to said Bank of Nevada Savings & Trust Company as security for said loan and had likewise executed said collateral agreement. That the said Reno National Bank at the time it

loaned the said John G. Taylor, Inc., the sum of $700,000 and accepted its promissory note, together with the real estate mortgage, and at the time it transferred said note and mortgage to the plaintiff Reconstruction Finance Corporation had, and always had full knowledge of the existence [27] of the various water stock corporations and full and complete knowledge that John G. Taylor was the principal owner and holder of the stock therein. Defendants further aver that the Reno National Bank accepted the real estate mortgage as security for the $700,000.00 loaned to John G. Taylor, Inc., with full knowledge and understanding that said real estate mortgage did not contemplate the transfer or hypothecation or encumbrance or lien upon any of the stock held by John G. Taylor in said various water corporations, and that said real estate mortgage did not cover or include or embrace any lien or encumbrance upon any of the water or water rights, water ways, ditches, dams or reservoirs held, owned or controlled by any or all of said so-called water corporations, or that any of said waters, water rights, ditches, dams or reservoirs, so held, owned and controlled by any or all of said so-called water corporations, were appurtenant to or connected with the lands described in said mortgage, or referred to or included therein.

These defendants further allege that at the time the $700,000 note and attendant mortgage were assigned to the plaintiff Reconstruction Finance Corporation by the Reno National Bank, none of said so-called water stock, or any share thereof, had been

hypothecated, transferred or delivered by John G. Taylor, or any one else, to the Reno National Bank, by way of additional security to the mortgage, or was ever held or possessed by the Reno National Bank, and that the plaintiff Reconstruction Finance Corporation accepted the assignment and delivery of the note and mortgage without any demand upon the Reno National Bank, or any one else, for the hypothecation, pledging, transferring or delivery of any certificates of stock in any of the so-called water companies and corporations. [28]

And For a Second, Further and Affirmative Defense, These Defendants Allege:

That the Humboldt-Lovelock Irrigation Light & Power Company, a corporation, and the other so-called water corporations in said bill of complaint referred to, are each and all corporations which were organized and maintained for profit, and that certificates and shares of stock therein, and particularly those of the Humboldt-Lovelock Irrigation Light & Power Company were sold, traded in and dealt with at market. That by virtue of their articles of incorporation and their by-laws, no limitation is or was placed restricting any person or class of persons from purchasing, holding or owning any shares or certificates of stock therein. That whatever rights with respect to the use or appropriation of water or waters upon any of the lands owned by any of the stockholders therein, emanated through contractual relations between the stockholders and the corporation or through affirmative action by their respective Boards of Directors; and

the use of any water or waters, reservoirs, ditches or rights of way, owned, held and controlled by said so-called water companies, is or was not restricted to the use of the stockholders therein.

And For a Third, Further, Separate Affirmative Defense Herein, These Defendants Allege:

That John G. Taylor, Inc., the mortgagor herein, owned no shares or certificates of stock in any or either of the so-called water companies and corporations referred to in said bill of complaint, could not, and by virtue of said mortgage, or otherwise, did not hypothecate nor could not have [29] hypothecated or transferred or conveyed or encumbered any part or portion of the water or waters or reservoirs or ditches or rights of way, held, owned and controlled by said water corporations or any thereof. And that at the time the said Reno National Bank, as mortgagee, accepted said mortgage from said John G. Taylor, Inc., it had full and complete knowledge that said John G. Taylor, Inc., had no title whatever to the water or waters, reservoirs, ditches, canals and rights of way then held, owned and possessed by Humboldt-Lovelock Irrigation Light & Power Company and other water corporations mentioned in said bill of complaint.

And For a Fourth, Further, Separate and Affirmative Defense, These Defendants Allege:

That the Reno National Bank, together with the Bank of Nevada Savings & Trust Company, operating by, under and through the same officials and Boards of Directors, had full and complete knowledge of the said mortgage referred to in said bill

of complaint and of the three several notes payable to the Bank of Nevada Savings & Trust Company secured by the hypothecation, transfer and delivery of the said so-called water stock. That should judgment be decreed herein, in favor of plaintiff, the said Bank of Nevada Savings & Trust Company would not only be deprived of any benefits from its said hypothecated stock security, but would suffer an irreparable and appreciable loss. That further, the said plaintiff in his said bill of complaint, while seeking equity, is not doing or tendering equity, and that said suit is unconscionable and inequitable.

PLATT & SINAI

Attorneys for Defendants. [30]

State of Nevada,
County of Washoe.—ss.

Leo F. Schmitt, being first duly sworn, upon oath, deposes and says: That he is one of the above named defendants, and makes this verification for and on behalf of all of said defendants; that he has read the foregoing answer and knows the contents thereof; that the same is true of his own knowledge, except as to those matters therein alleged on information or belief, and as to those matters, he believes it to be true.

LEO F. SCHMITT

Subscribed and Sworn to before me this 23rd day of June, 1936.

[Notarial Seal] JOHN S. SINAI

Notary Public in and for the County of Washoe, State of Nevada.

[Endorsed]: Filed June 24, 1936. [31]

[Title of District Court and Cause.]

SUPPLEMENTAL BILL OF COMPLAINT

Now comes Pacific States Savings & Loan Company, hereinafter called the complainant, and presents the following supplemental bill of complaint against the above-named defendant, and thereupon complains and alleges:

I.

That complainant at all times herein mentioned was and now is a corporation organized and existing under and by virtue of the laws of the State of California.

II.

That at all of the times herein mentioned, Pacific [32] States Auxiliary Corporation was and now is a corporation organized and existing under and by virtue of the laws of the State of California.

III.

That on the 1st day of November, 1934, Reconstruction Finance Corporation, a corporation organized and existing under and by virtue of the laws of the United States of America, duly filed its original bill of complaint against the defendant, in which said Reconstruction Finance Corporation prayed for certain relief, the particulars of which are set forth in full in the original bill of complaint filed in the office of the Clerk of this court on the 1st day of November, 1934, reference to which is hereby made as if the same was set forth herein in full.

IV.

That thereafter, to wit, on or about the 24th day of June, 1936, the defendant filed herein its answer to said bill of complaint.

V.

That on or about the 12th day of February, 1936, all of the right, title and interest of said Reconstruction Finance Corporation, and all other parties to that certain suit in equity lately pending in this court entitled "W. J. Tobin, as Receiver of The Reno National Bank vs. John G. Taylor, Inc., a corporation, et al" and numbered in the files of this Court No. H-114, in and to the stock described in Paragraph VII of the original bill of complaint, and the lands described in the schedule annexed to said original bill of complaint and marked Exhibit "A", was in pursuance of the decree of foreclosure and sale given and made by [33] this Court in said suit in equity on the 24th day of October, 1935, conveyed by the Special Master in Chancery appointed for that purpose by said decree of foreclosure and sale, to W. J. Tobin, as Receiver of The Reno National Bank, an insolvent national banking association, who thereafter, to wit, on or about the 10th day of September, 1936, conveyed said stock and lands to Pacific States Auxiliary Corporation, which thereafter in turn conveyed the same to complainant; that by virtue of said conveyances, complainant has succeeded to and is now vested with all of the right, title and interest of

said Reconstruction Finance Corporation in and to said stock and lands.

VI.

That the defendant, as well as each of the corporations of which he is receiver, is a citizen or resident of the state and judicial district of Nevada; that complainant is a citizen and resident of the State of California; and that the amount in controversy in this litigation exceeds $3,000, and that the jurisdiction of this Court over this cause has at no time been defeated.

Wherefore, complainant prays that it may be substituted as party plaintiff herein for said Reconstruction Finance Corporation, and that this cause may proceed to decree in complainant's favor, in accordance with the prayer of the original bill of complaint herein.

PACIFIC STATES SAVINGS & LOAN COMPANY,
BROBECK, PHLEGER & HARRISON
By N. J. BARRY
Its attorneys. [34]

We, the undersigned, attorneys for defendant, hereby admit service by copy of the within and foregoing complaint.

Dated: January 16, 1937.

PLATT & SINAI

[Endorsed]: Filed Jun. 18, 1937. [35]

[Title of District Court and Cause.]

OPINION AND DECISION

By the Court, Norcross, Judge.

This is a suit in equity to enjoin the sale of certain corporate stock in certain corporations and to obtain a declaration of the relative rights of Plaintiff and Defendant therein. The corporations were organized under the laws of the State of Nevada and are named as follows: Union Canal Ditch Company, Old Channel Ditch Company, Young Ditch Company and Humboldt Lovelock Irrigation Light and Power Company.

The testimony and evidence submitted establishes the following facts:

On and prior to June 9, 1930, John G. Taylor was the owner of certain irrigated lands in Lovelock Valley, particularly described in the bill of complaint. For many years prior to 1930 water for the irrigation of these lands had been and still is obtained from two sources—directly from the natural flow of the Humboldt River and from flood waters stored in the so-called [36] Pitt-Taylor Reservoir, which was and is owned by the Humboldt Lovelock Irrigation Light & Power Company. The water is conveyed from these sources to the lands by means of the Young Ditch, the Old Channel Ditch and the Union Canal, and certain other ditches. The ditches named have long been owned by incorporated ditch companies, namely the Young Ditch Company, The Old Channel Ditch Company and the Union Canal Company, the sole stockholders

of which have always been owners of land lying adjacent to the ditches. Taylor owned 1121-1/3 shares of the capital stock of the Old Channel Ditch Company, 2857 shares of the capital stock of the Young Ditch Company and 150 shares of the capital stock of the Union Canal Company. On June 9, 1930, John G. Taylor conveyed to John G. Taylor, Inc., all of his property, real, personal and mixed (excepting only property located in the corporate limits of the City of Lovelock) together with "all water rights, ditches and canals appurtenant to said land or used in connection therewith, and all shares of stock of any water corporation appurtenant to said land or the waters from which are used or have been used in connection with the irrigation or cultivation thereof. Water from the ditches and reservoir above mentioned had been applied to the beneficial use of the lands described in the bill of complaint long prior to the date of said deed. On April 17, 1932 John G. Taylor, Inc., as security for the payment of a promissory note in the principal amount of $700,000. mortgaged to The Reno National Bank all of the real property which it then owned or should thereafter acquire, "together with all water rights, water applications, water permits or privileges connected with, belonging, appurtenant or incident to the lands covered by said mortgage or used in connection with all or any part of said premises, or usable in connection therewith, and all dams, reservoirs and ditches, canals and other works for the storage or carrying of water then owned or

thereafter acquied by the mortgagor or in which the mortgagor then had or might thereafter acquire any interest, and [37] all applications then pending in the office of the State Engineer of the State of Nevada for any or all water to be used upon any part or portion of said lands or used in connection therewith." Immediately after the execution of this mortgage, The Reno National Bank pledged it and the note which it secured, to the Reconstruction Finance Corporation, as security for a loan. A day or two after the Reconstruction Finance Corporation had made to The Reno National Bank a loan in excess of $1,000,000 for the payment of which the Taylor mortgage was pledged as security, the Bank of Nevada Savings & Trust Company obtained from John G. Taylor a pledge agreement purporting to give to the Bank of Nevada Savings & Trust Company a lien upon the stock involved in this litigation as security for the payment of all existing or future indebtedness of John G. Taylor. At the time of the execution of the agreement neither John G. Taylor, Inc., nor John G. Taylor was indebted to the Bank of Nevada Savings & Trust Company, nor did either become indebted to that bank until sometime later. A month or two after the delivery of the agreement the Bank of Navada Savings & Trust Company lent to John G. Taylor, Inc., a total of $32,500 and took from John G. Taylor, Inc., three promissory notes for the total amount mentioned. These notes were endorsed by John G. Taylor, individually.

The several ditch companies (namely, the Young Ditch Company, the Old Channel Ditch Company and the Union Canal Company) never have been operated for profit. Their functions in practice have at all times been and now are limited to the maintenance and operation of the ditches which they respectively own. Whatever revenue they have required has been obtained by assessments levied upon their shareholders. By virtue of the shareholdings the stockholders of each of the companies are entitled to ratable shares of the carrying capacities of the respective ditches proportionate to the number of shares which they hold. [38]

By State Court decree adjudicating relative rights of appropriators of water from the Humboldt River, the right to the use of water carried through the several ditches above referred to are adjudged to be appurtenant to the place of use. None of the ditch companies are adjudged to have any water rights, with the exception of the Union Canal Company, and as to this company its water rights are adjudged to be appurtenant to certain specifically described lands which are owned by shareholders of the company, but which are not involved in this litigation. The lands referred to in the bill of complaint are adjudged to have certain rights of appropriation of water from the Humboldt River, but these rights are of such late priority that unless water for the irrigation of the lands can be obtained from the Pitt-Taylor Reservoir, the lands, except in years of exceptional precipitation, are semi-arid

and practically without value. In other words, water from the Pitt-Taylor Reservoir is absolutely essential to the profitable operation of the lands.

The Pitt-Taylor Reservoir was and is owned by the Humboldt Lovelock Irrigation Light & Power Company, which in turn is possessed of the right to store certain quantities of water taken from the Humboldt River for use on certain designated lands, including among other lands, the property referred to in the bill of complaint. These rights are evidenced by Certificates No. 2130 and No. 2131. The said certificates contain the following provision:

> "The stored waters as granted by this certificate are to be used only to supply any deficiency in the irrigation of vested right, lands herein listed as irrigated by direct diversion from the Humboldt River, and in no event shall such combined use exceed any duty of water decreed to such lands."

All of the right, title and interest of the Reconstruction Finance Corporation, The Reno National Bank, and John G. Taylor, Inc. in and to the stock through foreclosure of the mortgage executed in favor of The Reno National Bank and mesne conveyances, has passed to and become [39] vested in Pacific States Savings & Loan Company, which has been substituted as plaintiff in this proceeding, and the question presented for the Court's decision is whether the defendant has any lien upon the stock superior to the title of the plaintiff. On the basis of the pledge agreement coupled with possession of

the certificates evidencing the shares, defendant, as Receiver of the Bank of Nevada Savings & Trust Company, asserts a lien upon the stock as security for Taylor's endorsement of the three notes mentioned and that such stock represents ownership of all the water rights in respect to the land described in the said mortgage.

Shortly prior to the time of the final submission of this case, this Court in another case had occasion to determine the main question of law herein involved. In the case of United States v. Humboldt Lovelock Irrigation Light and Power Company, 19 F. Supp. 489, there was presented the question whether the United States was the owner of certain water rights in the Humboldt River for which it had paid the then upstream owners $419,000, for the purpose of changing the point of diversion downstream for use upon lands owned by others within a Government Reclamation Project—the Pershing County Water Conservation District. The United States in that case, like the ditch and reservoir companies in this case was not the owner of any land irrigated or to be irrigated by the water the ownership of which was or is in question. Relative to the law governing that question this Court in the opinion rendered in that case (p. 491) said:

> "The law is well settled in this state (Prosole v. Steamboat Canal Co., 37 Nev. 154, 140 P. 720, 144 P. 744) and in the states of the arid region generally, that water for irrigation is appurtenant to the lands irrigated and hence the prop-

erty of the owner of the land so irrigated. Ickes v. Fox, 65 App. D. C. 128, 85 F.(2d) 294, 298."

When John G. Taylor transferred his land holdings to John G. Taylor, Inc., the land transfer carried with it all water rights appurtenant thereto, irrespective of any other [40] expressions in the deed of transfer. Such water rights, so appurtenant, include means of transportation through the ditches constructed for delivery of the same. It also included a right to the water stored in the so-called Pitt-Taylor Reservoir for the use of such land because the same would become appurtenant thereto. Rights to water for irrigation of arid lands within this state is wholly distinct from rights which may be evidenced by corporation stock certificates. A corporation, except in the case of a water supply for municipal purposes, may not acquire a title to water for irrigation, except in cases where such corporation is also the owner of land upon which such water is so used and so becomes appurtenant thereto. A corporation like the Steamboat Canal Company, referred to in the citation supra, may acquire rights to charge and collect for supplying a means of transportation from the point of diversion to the place of use but, as in that case held, the water so used becomes appurtenant to the land to which it is applied and the right to delivery of the water to the land is only subject to a conveyance charge.

None of the corporations, the stock in which is here involved appears to be the owner of irrigated

lands. Such stock, therefore, does not present any element of interest in rights to water as such, particularly is this the case of the several ditch companies. It does not follow however, that because said ditch companies and said Humboldt Lovelock Irrigation Light and Power Company may have no water rights such as is appurtenant to land owned by said companies, that the stock therein may not represent some other, more or less, valuable rights.

A reference to the articles of incorporation of the several companies do not disclose that they were organized for the sole or primary purpose of supplying water for irrigation of any particular land. In the case of the Humboldt Lovelock Light and Power Company, as indicated by its name, it was [41] incorporated for other purposes in addition to that of storing and transporting water for irrigation. Stock therein might necessarily have a value for reasons wholly distinct from the matter of supplying water for irrigation of lands which, by its charter, is not confined to any definite tracts.

Counsel for Defendant Receiver calls the Court's attention to the Nevada statutes relating to corporations organized under the laws of this State providing that "shares of stock in every corporation shall be personal property and shall be transferable on the books of the corporation, in such manner and under such regulations as may be provided in the by-laws." Navada Compiled Laws ## 1617, 1722. The by-laws of each of the said corporations, the stock of which is here involved, makes provisions for such transfer.

Attention is also so directed to the State statute requiring a mortgage of personal property to have "appended or annexed thereto the affidavits of the mortgagor and mortgagee, * * * setting forth that said mortgage is made in good faith * * *." In the absence of such affidavit it is provided that the mortgage "is void as against creditors of the mortgagor and subsequent purchasers or incumbrancers of the mortgaged property in good faith and for value." Navada Compiled Laws, #987. The mortgage to the Reno National Bank did not have appended such affidavits.

A considerable portion of the brief for Defendant Receiver, is devoted to a contention that the equities in this case are in favor of Defendant and for that reason Plaintiff is not entitled to any relief. This contention is based primarily upon the fact that the officers and directors of the Reno National Bank and the Bank of Nevada Savings and Trust Company were the same personnel and that the said loans made by the two banks respectively were handled mainly by the same official. The opinion and decision of this Court in Schmitt, Receiver, v. [42] Reconstruction Finance Corporation, Case No. H-78, dealing with the question of subordination agreements entered into between a number of State banks and the Reno National Bank, all having in whole or in the main a common directorate, is cited in support of the contention. Without determining whether there may or may not be equities also growing out of the facts involved in this case, it

is sufficient now to say that the rights of the parties to this proceeding are controlled by rules and provisions of law wholly independent of equitable principles controlling upon the facts presented in the case last referred to. As heretofore stated, it is settled law that water diverted from a natural water channel for irrigation of arid land becomes appurtenant to the land and is subject to any mortgage of such land and passes with any conveyance thereof. As water for the reclamation of arid lands by means of irrigation may not be supplied thereto without the aid of ditches or canals for that purpose, and in some cases, also, the use of storage reservoirs, the right to the water carries with it rights in the means of delivery thereto. Such rights, as before stated, may be subject to conditions such as maintenance costs and other proper charges, not necessary or possible here to fully consider and determine.

Plaintiff is entitled to a decree as against Defendant, Receiver, to the effect that Plaintiff, as owner of the land described in the Bill of Complaint, is owner of the water for irrigation thereof as appurtenant to said land and also owner of rights in the said ditches as means of transportation and of storage rights in said reservoir, subject to maintenance charges. Whether any such transportation or storage rights may or may not be subject to any other charge is not herein involved.

Plaintiff is not entitled to decree respecting the stock or certificates therefor, referred to in the pleadings, otherwise than as such stock or certifi-

cates thereof, may be affected by the decree to which Plaintiff is entitled as above indicated. [43]

The Plaintiff is granted a decree accordingly.

Each of the parties will pay their own costs of suit.

Plaintiff is directed to submit proposed findings of fact and form of decree.

Dated this 1st day of October, 1937.

FRANK H. NORCROSS
District Judge.

[Endorsed]: Filed October 1, 1937. [44]

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This cause came on regularly for trial on the 17th day of January, 1937, before the court without a jury, and Messrs. N. J. Barry and Brobeck, Phleger & Harrison by Maurice E. Harrison, appearing as attorneys for plaintiff, and Messrs. Platt & Sinai, by Samuel Platt, Esq., for defendant Leo F. Schmitt, as Receiver of Bank of Nevada Savings & Trust Company, Carson Valley Bank, Tonopah Banking Corporation, and Virginia City Bank, and from the evidence introduced, the court finds the facts as follows, to-wit:

I.

That at all of the times herein mentioned Reconstruction Finance Corporation was and now is a

corporation organized and existing under and by virtue of the laws of the United States of America. [45]

II.

That at all of the times herein mentioned The Reno National Bank was and now is a national banking association, organized and existing under and by virtue of the banking laws of the United States of America, and having its principal office and place of business in the City of Reno, State of Nevada.

III.

That at all of the times herein mentioned plaintiff, Pacific States Savings & Loan Company, was and now is a corporation organized and existing under and by virtue of the laws of the State of California.

IV.

That at all of the times herein mentioned each of the following were and now are corporations organized and existing under and by virtue of the laws of the State of Nevada:

Bank of Nevada Savings & Trust Company
Carson Valley Bank
Tonopah Banking Corporation
Virginia City Bank
Humboldt-Lovelock Irrigation Light & Power Company
Old Channel Ditch Company
Union Canal Ditch Company
Young Ditch Company.

V.

That at all of the times herein mentioned, John G. Taylor, Inc. was and now is a corporation organized under the laws of the State of Wyoming.

VI.

That after due investigation of the financial condition of The Reno National Bank, the Comptroller of the Currency of the United States of America found said bank to be insolvent, and on or about the 9th day of December, 1932, in accordance with the statutes of the United States of America in such cases made and provided, appointed Walter J. Tobin, Receiver of said bank and of the assets thereof.

That thereafter, and on the 12th day of December, 1932 [46] said Walter J. Tobin duly qualified as such Receiver and ever since has been and now is the Receiver of said The Reno National Bank.

VII.

That thereafter such proceedings were duly had and taken in and by the District Court of the State of Nevada in and for the First Judicial District that by orders and judgments duly given and made by said court on the 28th day of February, 1934, Leo F. Schmitt was appointed Receiver of each of the following banking corporations:

Bank of Nevada Savings & Trust Company
Carson Valley Bank
Tonopah Banking Corporation
Virginia City Bank.

That immediately thereafter said Leo F. Schmitt duly qualified as such Receiver and ever since has been and now is the duly appointed, qualified and acting Receiver of said corporations, and of the business, property and assets of each thereof.

VIII.

That on the 9th day of June, 1930, and for many years prior thereto, John G. Taylor was the owner of the following number of shares of the capital stock of the respective companies indicated:

37,273 shares Class A stock of Humboldt-Lovelock Irrigation Light & Power Company
2,857 shares of Young Ditch Company
150 shares of Union Canal Company
1,121-1/3 shares of Old Channel Ditch Company.

That said shares of stock are hereinafter referred to as "said water stock" and said companies are hereinafter referred to as "said water companies".

IX.

That as more fully hereinafter set forth, by virtue of his (the said John G. Taylor's) ownership of certain lands situate in the Lovelock Valley, more particularly described in the schedule hereunto annexed and marked Exhibit "A", the [47] ownership of said water stock vested in the said John G. Taylor certain rights (hereinafter referred to as "water rights") to the use, in common with the other shareholders of said water companies, of the

reservoirs, ditches and other facilities of the respective water companies for the storage and transportation of water for use upon said lands.

X.

That on the 9th day of June, 1930, said John G. Taylor made, executed and delivered to John G. Taylor, Inc., a corporation organized and existing under and by virtue of the laws of the State of Wyoming a deed reading in part, as follows:

> "That the party of the first part, * * *, does by these presents grant, bargain, sell and convey to the party of the second part * * *, all of the following described lots, pieces or parcels of land situated in the State of Nevada, and more particularly described as follows, to-wit: all property, real, personal or mixed, now owned by me and located in the State of Nevada, save and except such property * * * located within the corporate limits of the City of Lovelock, County of Peshing, State of Nevada.
>
> "Together with the appurtenances and all rents, issues and profits thereof; also all water rights, ditches and canals appurtenant to said land or used in connection therewith, and all shares of stock of any water corporation appurtenant to said land, or the water from which are used or have been used in connection with the irrigation or cultivation thereof."

That said deed was duly acknowledged and was thereafter duly recorded in the offices of the County

Recorders of the Counties of Pershing, Humboldt and Elko, State of Nevada, on or about the 12th day of June, 1930. That no part of the lands referred to in Paragraph IX hereof, or said water rights [48] was or is located within the corporate limits of said City of Lovelock. That by virtue of said deed all of said lands and water rights passed to and became vested in the said John G. Taylor, Inc.

XI.

That on the 12th day of March, 1932, said John G. Taylor, Inc. made, executed and delivered to The Reno National Bank its promissory note payable on demand to the order of The Reno National Bank, in the principal amount of $700,000. That simultaneously with the execution and delivery of said promissory note, said John G. Taylor, Inc., for the purpose of securing the payment of said promissory note, made, executed and delivered to The Reno National Bank a real estate mortgage and a chattel mortgage. That each of said mortgages was duly acknowledged by the said John G. Taylor Inc. so as to entitle it to be recorded and each of said mortgages was in fact recorded in the office of the County Recorders of the Counties of Humboldt, Pershing and Elko, State of Nevada. That thereafter, an error having been discovered in said real estate mortgage, the said John G. Taylor, Inc. on or about the 27th day of April 1932, for the purposes of securing the said promissory note, made, executed and delivered to The Reno National Bank

a new real estate mortgage dated as of the 12th day of March, 1932, which said real estate mortgage was duly acknowledged so as to entitle it to be recorded, and the same was duly recorded in the offices of the County Recorders of the Counties of Humboldt, Pershing and Elko, State of Nevada.

XII.

That in and by each of the real estate mortgages mentioned in the next preceding paragraph hereof, the said John G. Taylor, Inc. mortgaged unto The Reno National Bank all of the lands referred to in Paragraph IX hereof, as well as all other lands and interests in lands which the said [49] John G. Taylor, Inc. then owned, together with all water, water rights, water applications, water permits or privileges connected with, belonging, appurtenant or incident to the lands covered by said mortgage or used in connection with all or any part of said premises, or used or usable in connection therewith, and all dams, reservoirs and ditches, canals, and other works for storage or carrying of water then owned by the mortgagor or in which the mortgagor then had or might thereafter acquire any interest, and all applications then pending in the office of the State Engineer of the State of Nevada for any and all water to be used upon any part or portion of said lands, or used in connection therewith.

XIII.

That prior to the fifth day of May, 1932, The Reno National Bank endorsed, transferred and de-

livered the aforesaid promissory note of John G. Taylor, Inc. in the principal amount of $700,000.00, together with the mortgages securing the same, to Reconstruction Finance Corporation, as collateral security for a loan far in excess of the amount of said promissory note.

XIV.

That in making said loan to The Reno National Bank the Reconstruction Finance Corporation placed a value on the lands described in the schedule annexed to the complaint and marked Exhibit "A", based on the assumption that the said mortgages constituted a valid and paramount lien on all water rights appurtenant to said lands or in any way affected or evidenced by the stock referred to in Paragraph VIII hereof. That the Reconstruction Finance Corporation did not know nor did it have any reason to believe that any of the said water rights were evidenced by corporate stock, but assumed that the said rights were appurtenant to said lands so as to pass with a mortgage or conveyance thereof. That if the Reconstruction Finance Corporation suspected that any claim would be made that [50] said water rights were not covered by said mortgages, it would not have made to The Reno National Bank any loan in the amount which it did, but if it had made to said The Reno National Bank any loan at all, then and in such case the amount thereof would have been decreased at least to the extent of the value of said water rights.

XV.

That after the said Reconstruction Finance Corporation had made said loan to The Reno National Bank and said The Reno National Bank had pledged said note and mortgages to the Reconstruction Finance Corporation, the Bank of Navada Savings & Trust Company obtained from John G. Taylor a pledge agreement purporting to give the Bank of Nevada Savings & Trust Company a lien upon the stock referred to in Paragraph VIII hereof, as security for the payment of all existing or future indebtedness of John G. Taylor; that at the time of the execution of said agreement, neither John G. Taylor, Inc. nor John G. Taylor was indebted to the Bank of Nevada Savings & Trust Company, nor did either become indebted to that bank until a month after the said mortgages had been pledged and assigned to the said Reconstruction Finance Corporation. That a month or two after the delivery of said pledge agreement and the pledge and assignment of said mortgages to the Reconstruction Finance Corporation, the Bank of Nevada Savings & Trust Company lent to John G. Taylor, Inc. a total of $32,500 and took from John G. Taylor, Inc. three promissory notes for the total amount mentioned, which notes were endorsed by John G. Taylor individually. That by virtue of said pledge agreement, defendant Leo F. Schmitt, as receiver of Bank of Nevada Savings & Trust Company, asserted a lien upon the shares of stock referred to in Paragraph VIII hereof, for the payment of the indebtedness evidenced by said notes.

XVI.

That for many years prior to 1930, water for the [51] irrigation of the lands referred to in Paragraph XI hereof had been and still is, obtained from two sources, directly from the natural flow of the Humboldt River, and from flood waters stored in the so-called Pitt-Taylor Reservoir, which at all times herein mentioned was and now is owned by the Humboldt-Lovelock Irrigation Light & Power Company. That water is conveyed from these sources to the lands referred to in Paragraph XI of these findings by means of the Young Ditch, which is owned by the Young Ditch Company, the Old Channel Ditch, which is owned by the Old Channel Ditch Company, and the Union Canal, which is owned by the Union Canal Company, and certain other ditches. That at all of the times herein mentioned, water from the ditches and reservoir above-mentioned has been and now is, applied to beneficial use upon the lands described in Paragraph XI hereof.

XVII.

That the said Young Ditch Company, the Old Channel Ditch Company and the Union Canal Company have never been operated for profit; that their sole functions and practice have at all times been and now are limited to the maintenance and operation of the ditches which they respectively own, which, together with works for the diversion of water into said ditches, constitute their only assets. That at all of the time herein mentioned the said

companies have derived their only revenue from assessments levied upon their respective shareholders. That with few, if any, exceptions the shareholders of said companies at all of the times herein mentioned have been and now are owners of lands lying adjacent to the ditches owned by said companies. That by virtue of their shareholdings, the stockholders of each of said companies are entitled to ratable shares of the carrying capacities of the respective ditches proportionate to the number of shares which they respectively hold. [52]

XVIII.

That by a decree duly given and made by the Third Judicial District Court of the State of Nevada adjudicating the relative rights of the appropriators of water from the Humboldt River, the right to use the water carried in the ditches above referred to are adjudged to be appurtenant to the place of use. That neither the Young Ditch Company nor the Old Channel Ditch Company are adjudged to have any right to divert or appropriate water from the Humboldt River, that the Union Canal Company is adjudged to have certain water rights but said rights are declared and adjudged to be appurtenant to certain specifically described lands which are owned by shareholders of the company, but which are not involved in this litigation.

XIX.

That the lands described in Paragraph XI hereof are adjudged by said decree to have certain rights

of appropriation of water from the Humboldt River; that said rights are of such late priority that unless water for the irrigation of the lands described in Paragraph XI hereof can be obtained by the Pitt-Taylor Reservoir, the said lands, except in years in exceptional precipitation, are semi-arid and practically without value. That water from the Pitt-Taylor Reservoir is absolutely essential to the profitable operation of said lands, and that without the use of the ditches owned by the said Young Ditch Company, the Old Channel Ditch Company and the Union Canal Company, the said lands cannot be irrigated, and the use of said ditches is absolutely essential to the profitable irrigation of said lands.

XX.

That the Pitt-Taylor Reservoir was and is owned by the Humboldt-Lovelock Irrigation Light & Power Company. That the Humboldt-Lovelock Irrigation Light & Power Company is possessed of the right to store certain quantities of water taken from the Humboldt River for use on certain designated lands, including [53] among other lands the lands described in Paragraph XI hereof. That the rights of the Humboldt-Lovelock Irrigation Light & Power Company to store certain water are evidenced by certificates Nos. 2130 and 2131 issued by the State Engineer of the State of Nevada; that said Certificates contain the following provision:

> "The stored waters as granted by this certificate are to be used only to supply any deficiency

in the irrigation of vested right, lands herein listed as irrigated by direct diversion from the Humboldt River, and in no event shall such combined use exceed any duty of water decreed to such lands."

That in practice the sole functions of said Humboldt-Lovelock Irrigation Light & Power Company at all times have been and now are limited (a) to diverting and storing water for the exclusive benefit of lands owned or then owned by its stockholders, and (b) to the maintenance and operation, for the purpose of diverting and storing water for the benefit of lands owned or then owned by its stockholders, of said Pitt-Taylor Reservoir and works for the diversion of water into said reservoir; that said reservoir and diversion works constitute the sole and only tangible assets of said Humboldt-Lovelock Irrigation Light & Power Company; that said Humboldt-Lovelock Irrigation Light & Power Company has not at any time manufactured, sold, or distributed light or power, or engaged in any business or activity other than the business or activity of acting as the agent of its stockholders in diverting and storing water to be applied to a beneficial use upon the lands owned by such shareholders; that it has never been operated for profit; that its sole source of revenue has consisted of an annual charge collected from its stockholders on the basis of the quantity of water delivered to them and assessments levied upon its shareholders to make

up the deficiency of the revenue provided by said annual charge to cover the costs of maintaining and operating said Pitt-Taylor Reservoir and works for the diversion of water.

XXI.

That the Humboldt-Lovelock Irrigation Light & Power [54] Company has two classes of stock designated respectively as Class A stock and Class B stock; that the holder of each share of Class A stock is entitled to receive from said corporation that proportion of the first 10,000 acre feet of water stored in the Pitt-Taylor Reservoir, which the number of shares which he holds bears to the total issued and outstanding number of Class A shares of said corporation, for use upon lands lying adjacent to certain designated ditches, including among others the Young Ditch, the Old Channel Ditch and the Union Canal. That upon transfer of any shares of Class A stock of said corporation, except in connection with the transfer of the lands upon which said water has been applied to a beneficial use, said shares of Class A stock automatically become shares of said Class B stock.

XXII.

During the pendency of this action, in a suit to foreclose the mortgages given by John G. Taylor, Inc. to The Reno National Bank and pledged by The Reno National Bank to the Reconstruction Finance Corporation, as more particularly hereinbefore set forth, a decree of foreclosure and sale

was duly given and made by this Court, in pursuance of which all of the property, real, personal and mixed, of every nature and description, and wheresoever situate, subject to said mortgages, was sold by a Special Master in Chancery appointed by this Court, to the Reconstruction Finance Corporation, which caused the said property to be conveyed by said Special Master in Chancery to W. J. Tobin, as Receiver of The Reno National Bank, in trust nevertheless for the Reconstruction Finance Corporation; that thereafter the property so conveyed to the said W. J. Tobin, as such receiver in trust as aforesaid, was by the said W. J. Tobin as such receiver, with the consent of the Reconstruction Finance Corporation, sold, transferred and conveyed to Pacific States Auxuliary Corporation, a California corporation, which corporation thereafter sold, transferred and conveyed the same [55] to Pacific States Savings & Loan Company; that thereafter said Pacific States Savings & Loan Company was substituted as the plaintiff in this action.

From the foregoing Findings of Fact, the Court draws the following:

Conclusions of Law.

I.

That Pacific States Savings & Loan Company is the owner of the lands described in Exhibit "A" attached to the complaint and of all water and water rights appurtenant thereto used for the irrigation of the same and rights to all means of transporta-

tion and storage of such appurtenant water rights, such as dams, ditches, canals and reservoirs, from the places or points of diversion to the places or points of use, subject only to normal costs of maintenance of such dams, ditches, canals and reservoirs.

II.

That, subject to the foregoing rights of Plaintiff, Pacific States Savings and Loan Company, Defendant, Leo F. Schmitt, as Receiver of Bank of Nevada Savings & Trust Company, Carson Valley Bank, Tonopah Banking Corporation and Virginia City Bank, is entitled to a lien on all the shares of stock referred to in Paragraph VIII of the Findings of Fact.

III.

That Plaintiff is not entitled to a judgment declaring said water stocks are subject to and conveyed by the lien of the real estate mortgage or to the lien of plaintiff for payment of the promissory note therein described or other than declaring the rights of the parties as set forth in the preceding Conclusions I and II.

Costs are not allowed either party.

Dated the 6th day of April, 1938.

(s) FRANK H. NORCROSS
District Judge.

[Endorsed]: Filed April 6, 1938. [56]

In the District Court of the United States of America, in and for the District of Nevada.

No. H-117.

PACIFIC STATES SAVINGS & LOAN COMPANY, a corporation, substituted for Reconstruction Finance Corporation, a corporation,
Plaintiff,

vs.

LEO F. SCHMITT, as Receiver of BANK OF NEVADA SAVINGS & TRUST COMPANY, CARSON VALLEY BANK, TONOPAH BANKING CORPORATION and VIRGINIA CITY BANK,
Defendant.

FINAL DECREE.

This cause for declaratory relief came on to be heard on January 17, 1937, and was thereafter, upon oral argument and briefs filed by respective counsel, submitted March 25, 1938. The Court having made Findings of Fact and Conclusions of Law, now in pursuance thereof, it is Ordered, Adjudged and Decreed as follows:

That the Plaintiff, Pacific States Savings & Loan Company, is the owner of the lands described in Exhibit "A" attached to the complaint and of all water and water rights appurtenant thereto used for the irrigation of the same and rights to and in all means of transportation and storage of such appurtenant water rights, such as dams, ditches,

canals and reservoirs, from the places or points of diversion to the places or points of use, subject only to normal costs of maintenance of such dams, ditches, canals and reservoirs.

That, subject to the foregoing rights of Plaintiff, Defendant, Leo F. Schmitt, as Receiver of Bank of Nevada [57] Savings & Trust Company, Carson Valley Bank, Tonopah Banking Corporation and Virginia City Bank, is entitled to a lien on all the shares of stock referred to in paragraph VIII of the Findings of Fact.

That Plaintiff is not entitled to a judgment declaring said water stocks are subject to and conveyed by the lien of the real estate mortgage or to the lien of plaintiff for payment of the promissory note therein described or other than declaring the rights of the parties as herein above set forth.

Costs are not allowed either party.

Dated this 6th day of April, 1938.

/s/ FRANK H. NORCROSS
District Judge.

[Endorsed]: Filed April 6, 1938. [58]

[Title of District Court and Cause.]

PETITION OF PACIFIC STATES SAVINGS AND LOAN COMPANY FOR REHEARING

The petition of Pacific States Savings & Loan Company for a rehearing, respectfully shows:

1. On April 6, 1938, this court made and filed its findings of fact and conclusions of law and entered its final decree.

2. Plaintiff respectfully petitions the Court for a rehearing on the ground that the court erred in each of the following respects:

(a) In not concluding as a matter of law and decreeing that plaintiff is the owner of the [59] stock referred to in the bill of complaint;

(b) In not concluding as a matter of law and decreeing plaintiff to be entitled to the possession of the certificate evidencing said stock;

(c) In not concluding as a matter of law and decreeing that the rights to receive water from the respective companies and to use the diversion works, storage facilities, dams, ditches and other facilities for the diversion, storage and conveyance of water belonging to the respective companies (all of which rights are hereinafter in this petition referred to as water rights) are appurtenant to the land;

(d) In not concluding as a matter of law and decreeing plaintiff to be the owner of the said stock, free from any claim or lien on the

part of the defendant, at least to the extent necessary to the full enjoyment of the water rights evidenced thereby;

(e) In not enjoining the defendant from transferring the certificates evidencing said stock, except subject to the rights of the plaintiff as declared by the decree; and in not requiring defendant to surrender up the certificates evidencing said stock for the purpose of having endorsed thereon a legend to the effect that plaintiff is entitled to all of the water rights evidenced by said stock as declared by the decree;

(f) In not concluding as a matter law and decreeing that plaintiff is entitled to vote the stock in respect to all matters relating to the rights which the Court has found to be vested in the plaintiff;

(g) In concluding as a matter of law and in decreeing that defendant in his capacity as Receiver of the Carson Valley Bank, Virginia City Bank and Tonopah Banking Corporation, has a lien on said stock;

(h) In concluding as a matter of law and decreeing that defendant in his capacity as receiver of Bank of Nevada Savings & Trust Company has a lien on said stock without specifying the amount or extent of such lien;

(i) In concluding and decreeing that plaintiff is not entitled to a judgment declaring the water stock to be subject to the real estate mortgage;

(j) In not concluding as a matter of law and decreeing that the deed executed by John G. Taylor to John G. Taylor Inc. under date of June 9, 1930 divested John G. Taylor of all right, title and interest in and to the stock involved in this litigation.

* * * (pp. 3 to 8 inc.) [60]

Wherefore, plaintiff respectfully prays that a rehearing may be granted and the Findings of Fact and Conclusions of Law and Final Decree be modified as herein prayed.

Respectfully submitted,

BROBECK, PHLEGER & HARRISON

N. J. BARRY

T. W. DAHLQUIST

Attorneys for Plaintiff. [61]

State of California,
City and County of San Francisco.—ss.

A. M. Dreyer, being first duly sworn, deposes and says:

That he is one of the attorneys for the plaintiff in the above-entitled action; that he has read the foregoing petition for rehearing, and that he does now state that the grounds of said petition as stated therein are believed by him to be well taken and in conformance with the facts, decisions and authorities relating thereto, and that all allegations of fact

contained therein are true to the best of his knowledge, information and belief.

A. M. DREYER

Subscribed and sworn to before me this 19th day of April, 1938.

[Seal] EUGENE P. JONES

Notary Public in and for the City and County of San Francisco, State of California.

[Endorsed]: Filed April 20, 1938. [62]

[Title of District Court and Cause.]

MEMORANDUM DECISION RE PETITION FOR REHEARING, MOTION TO VACATE DECREE.

Norcross, District Judge:

Final decree was entered in this suit April 6, 1938. Plaintiff on April 20, 1938, filed a petition for rehearing and thereafter on April 26th filed a notice of motion for an order vacating the final decree and permitting plaintiff to file a Second Supplemental Bill of Complaint.

The only question presented in the original suit was that of ownership of certain stock certificates in certain corporations organized for the purpose of acquiring, constructing or operating certain irrigation ditches, dams and reservoirs, 20 F. Sup. 816. In accordance with that decision plaintiff's water rights were not affected by the mere ownership of the stock certificates, as such water rights and

means of conveyance thereof were appurtenant to the lands owned by plaintiff. [63]

The purpose of the proposed Second Supplemental Bill of Complaint is to make the particular corporations, four in number, defendants and obtain a final decree against such corporation defendants forever enjoining them and each of them "from transferring upon their books the said shares or any thereof, except subject to the rights of the plaintiff as declared by said decree, and from issuing any certificates evidencing said shares or any thereof unless such certificates and each of them bear a legend declaring the rights of the registered holders thereof to be subject to the rights of the plaintiff as declared by such final decree".

In accordance with the decree as heretofore entered plaintiff can at any time maintain an action against any of said companies in the event of interference with its water rights regardless of any question of stock ownership. We may assume such rights have been determined in the Humboldt River suit.

The Court is not impressed that any sound reason is presented for the granting of the Petition or Motion. Cyclopedia of Federal Procedure, Vol. 3, Sec. 917, Vol. 4, Sec. 1110; New Equity Rule 34; 21 C. J. Secs. 660, 662.

The petition for rehearing and the motion to vacate the decree with permission to file a Second Supplemental Bill of Complaint should be denied.

It is so ordered.

Dated this 27th day of June, 1938.

FRANK H. NORCROSS
District Judge.

[Endorsed]: Filed June 27, 1938. [64]

[Title of District Court and Cause.]

PETITION FOR APPEAL

To the Honorable the United States District Court for the District of Nevada:

Comes now the plaintiff above-named, Pacific States Savings & Loan Company, a corporation, by its undersigned attorneys, and, feeling aggrieved by the decree made and entered in the above-entitled Court on April 6, 1938, which became final on June 27, 1938, upon the denial of a petition for rehearing seasonably made and filed and duly entertained by the Court, [65] hereby appeals from said decree to the United States Circuit Court of Appeals for the Ninth Circuit, and claims that there are manifest, material and prejudicial errors to its injury in said cause; that said errors are specifically set forth in the Assignment of Errors filed herewith upon which said appeal is based and to which reference is hereby made; and respectfully prays that said appeal be allowed and that a citation be issued in accordance with law; and that an authenticated transcript of the record, proceedings, exhibits and papers on the trial of this cause be sent to the United States Circuit Court of Appeals for the Ninth Circuit at San Francisco, California.

And your petitioner further prays that an order be made fixing the amount of security to be given by appellant, conditioned as provided by law.

Dated: August 22, 1938.

BROBECK, PHLEGER & HARRISON
ORRICK, DAHLQUIST, NEFF & HERRINGTON
Attorneys for Plaintiff Pacific States Savings & Loan Company. [66]

Receipt of a copy of the within Petition for Appeal is hereby admitted this .... day of ...., 1938.

....
Attorneys for Defendant.

[Endorsed]: Filed Aug. 22, 1938. [67]

[Title of District Court and Cause.]

ASSIGNMENT OF ERRORS.

Comes now Pacific States Savings & Loan Company, a corporation, plaintiff in the above-entitled cause, and files the following Assignment of Errors, to wit:

1.

The Court erred in making and entering its decree that defendant is entitled to a lien on the shares of

stock described in the complaint herein (hereinafter called "water [68] stocks"), viz.,

37,273 shares Class A stock of Humboldt-Lovelock Irrigation Light & Power Company;
2,857 shares of Young Ditch Company;
150 shares of Union Canal Company;
1,121 1/3 shares of Old Channel Ditch Company.

Said companies are hereinafter referred to collectively as "water companies."

2.

The Court erred in making and entering its decree that plaintiff is not entitled to a judgment declaring that said water stocks are subject to and conveyed by the lien of the real estate mortgage described in the complaint herein.

3.

The Court erred in not making and entering its judgment that plaintiff is the owner and entitled to the possession of said water stocks and that defendant has no right, title or interest therein or thereto or any lien thereon.

4.

The Court erred in not making and entering its decree that defendant surrender and deliver said water stocks to plaintiff.

5.

The Court erred in finding, in Finding IX, that the ownership of said water stocks vested in John G. Taylor, the predecessor in interest of both parties hereto, the right to use in common with other shareholders of the water companies whose stocks are described in the complaint, the reservoirs, ditches and other facilities of said respective water companies for the storage and transportation of water for use [69] upon the lands then owned by said Taylor and now owned by plaintiff.

6.

The Court erred in finding, in Finding XVII, that by virtue of their shareholdings the stockholders of each of said water companies are entitled to ratable shares of the carrying capacities of the respective ditches owned by said companies proportionate to the number of shares which said stockholders respectively hold.

7.

The Court erred in failing to find that, by virtue of the deed described in Finding X, said water stocks were sold, assigned and transferred by John G. Taylor to John G. Taylor, Inc., a corporation.

8.

The Court erred in failing to find that, by virtue of the mortgage referred to in Finding XI and XII, said water stocks were mortgaged by John G. Taylor, Inc. to The Reno National Bank.

9.

The Court erred in failing to find that, by virtue of the transactions described in Finding XXII, plaintiff is now the owner and entitled to the possession of said water stocks.

10.

The Court erred in failing to find that at the time the pledge agreement and loan described in Finding XV were made, John G. Taylor had no right, title or interest in or to said water stocks and that the interest of John G. Taylor, Inc. therein was subject to the mortgage theretofore made by John G. Taylor, Inc. to The Reno National Bank, and that the Bank of [70] Nevada Savings & Trust Company at all said times had notice and knowledge that said water stocks had theretofore been sold by John G. Taylor to John G. Taylor, Inc. and by the latter mortgaged to The Reno National Bank.

11.

The Court erred in failing to find that said water stocks were and are appurtenant to the lands described and referred to in said complaint now owned by plaintiff, and that said water stocks were transferred by the deed and mortgage of said lands.

12.

The Court erred in denying leave to complainant to file a supplemental bill of complaint and to make

said water companies parties defendant herein, and in failing to reopen said case in order that a complete adjudication of the rights of the parties might be obtained.

Wherefore, said Pacific States Savings & Loan Company, a corporation, appellant, prays that the decree of the District Court of the United States for the District of Nevada, entered in the above-entitled cause on April 6, 1938, be reversed and said cause remanded to said District Court with directions to enter a decree as prayed for in the Bill of Complaint herein, and for such other and further relief as may be just and appropriate.

Dated this 22 day of August, 1938.

BROBECK, PHLEGER & HARRISON
ORRICK, DAHLQUIST, NEFF & HERRINGTON
Attorneys for Pacific States Savings & Loan Company.
[71]

Receipt of a copy of the within Assignment of Errors is hereby admitted this.................day of ...., 1938.

....
Attorneys for Defendant.

[Endorsed]: Filed Aug. 22, 1938. [72]

[Title of District Court and Cause.]

ORDER ALLOWING APPEAL.

The above-named Pacific States Savings & Loan Company, plaintiff in the above-entitled cause, having filed herein its Petition for an appeal from the decree made and entered in said cause on April 6, 1938, which became final on June 27, 1938, upon the denial of a petition for rehearing seasonably made and filed and duly entertained by the Court, and having filed herein its Assignment of Errors, and prayer for reversal, pursuant to the statutes and rules in such [73] cases provided, now, on motion of the attorneys for said petitioner,

It Is Hereby Ordered that an appeal to the United States Circuit Court of Appeals for the Ninth Circuit from said decree be and the same is hereby allowed; and

It Is Further Ordered that the Clerk of this Court prepare and certify a transcript of the record, proceedings, exhibits and papers on the trial of this cause pertinent to and necessary for determination of said appeal and transmit the same to the United States Circuit Court of Appeals for the Ninth Circuit, at San Francisco, California, within the time and in the manner provded by the statutes of the United States and the rules of Court; and

It Is Further Ordered that the appellant furnish a bond on appeal in compliance with law and the rules of Court, in the amount of $500.00, the same to operate as a cost bond only.

Dated this 22nd day of August, 1938.

By the Court,

FRANK H. NORCROSS,

District Judge.

Attest:

[Seal] O. E. BENHAM,

Clerk of the United States District Court for the District of Nevada.

By O. F. PRATT

Deputy Clerk. [74]

Receipt of a copy of the within Order Allowing Appeal is hereby admitted this.................. ......day of ...., 1938.

....

Attorneys for Defendant.

[Endorsed]: Filed Aug. 22, 1938. [75]

[Title of District Court and Cause.]

UNDERTAKING ON APPEAL.

Know All Men By These Presents:

That Pacific Indemnity Company, a corporation organized and existing under and by virtue of the laws of the State of California, having power to execute bonds and undertakings in judicial proceedings and duly authorized to transact a general surety business within the State and District of Nevada, is held and firmly bound unto Leo F. Schmitt, as [76] Receiver of Bank of Nevada Savings & Trust

Company, Carson Valley Bank, Tonopah Banking Corporation and Virginia City Bank, in the full and just sum of $500.00, for the payment of which, well and truly to be made to said Leo F. Schmitt, as Receiver of Bank of Nevada Savings & Trust Company, Carson Valley Bank, Tonopah Banking Corporation and Virginia City Bank, it binds itself, its successors and assigns, jointly and severally by these presents.

Whereas, Pacific States Savings & Loan Company has prosecuted its appeal to the United States Circuit Court of Appeals for the Ninth Circuit to reverse the decree made and entered in the above-entitled cause by the United States District Court for the District of Nevada, on April 6, 1938;

Now, Therefore, the condition of this obligation is such, that if the said appellant shall prosecute its appeal to effect, and answer all costs if it fails to make good its plea, then this obligation to be void, otherwise to remain in full force and virtue.

The said Pacific Indemnity Company, a corporation, agrees that in case of breach of any condition hereof, the said District Court of the United States may, upon notice to it of not less than ten days, proceed summarily in the above suit to ascertain the amount which it is bound to pay on account of such breach and render judgment against it, and award execution thereon.

In Witness Whereof, the corporate seal and name of said Pacific Indemnity Company is hereto affixed

and attested by its duly authorized officers, this 22nd day of August, 1938.

PACIFIC INDEMNITY COMPANY
By W. F. AMES, JR.
Attorney-in-Fact.

The foregoing undertaking is hereby approved as to form, amount and sufficiency.

Dated: August 22, 1938.

FRANK H. NORCROSS
District Judge. [77]

Receipt of a copy of the within Undertaking on Appeal is hereby admitted this.................day of August, 1938.

....
Attorneys for Defendant-Appellee.

[Endorsed]: Filed Aug. 22, 1938. [78]

[Title of District Court and Cause.]

ORDER ENLARGING TIME TO PREPARE TRANSCRIPT OF RECORD AND TO DOCKET APPEAL.

Good cause appearing therefor, It Is Hereby Ordered that the time within which to prepare the transcript of record on appeal and to docket the appeal of the plaintiff in the above entitled suit in the United States Circuit Court of Appeals for the

Ninth Circuit be and the same is hereby enlarged to and including the 1st day of November, 1938.

Dated: September 7th, 1938.

FRANK H. NORCROSS
Judge of the United States
District Court.

[Endorsed]: Filed Sept. 7, 1938. [79]

[Title of District Court and Cause.]

STATEMENT OF EVIDENCE.

The above-entitled cause came on regularly for trial before the Court on the 18th and 19th days of January, 1937, Messrs. M. E. Harrison and A. M. Dreyer, of Brobeck, Phleger & Harrison, San Francisco, California, and N. J. Barry, of Reno, Nevada, appearing as attorneys for plaintiff, [80] and Samuel Platt, Esq., of Messrs. Platt & Sinai, Reno, Nevada, appearing as attorney for defendant.

Thereupon witnesses were called by the respective parties, duly sworn and testified as hereinafter set forth, and exhibits were introduced by the respective parties, and the cause was submitted for decision.

At the commencement of the trial leave was granted by the Court to file the Supplemental Bill of Complaint hereinbefore set forth, and Pacific States Savings & Loan Company, a corporation, was substituted as plaintiff in the place and stead

of Reconstruction Finance Corporation, a corporation. It was thereupon stipulated that that portion of Paragraph V of said Supplemental Bill of Complaint which alleges that pursuant to the decree of foreclosure and sale in said paragraph referred to the stocks which are the subject matter of this action were sold by a master appointed for that purpose in said decree of foreclosure and thereafter in turn conveyed to the substituted complainant, should be deemed controverted.

The evidence adduced in said cause, condensed and reduced to narrative form, is as follows:

PLAINTIFF'S EXHIBIT NO. 1

is a deed dated June 9, 1930, from John G. Taylor, of Lovelock, Nevada, to John G. Taylor, Inc., a Wyoming corporation, duly executed, acknowledged and recorded, by which said John G. [81] Taylor did grant, bargain, sell and convey to John G. Taylor, Inc., "all property, real, personal and mixed, now owned by me and located in the State of Nevada, save and except such property as is now standing in my name and which is located within the corporate limits of the City of Lovelock, County of Pershing, State of Nevada. Together with the appurtenances and all rents, issues and profits thereof; also all water rights, ditches and canals appurtenant to said land or used in connection therewith, and all shares of stock of any water corporation appurtenant to said land, or the waters from which are used or have been used in connection with the irrigation or cultivation thereof.

It was alleged in the Bill of Complaint, and admitted by the Answer, that none of the lands or water rights involved in this cause were or are located in the City of Lovelock.

PLAINTIFF'S EXHIBIT NO. 2

is a mortgage dated March 12, 1932, executed on April 20, 1932, duly acknowledged and recorded, between John G. Taylor, Inc., a Wyoming corporation, and The Reno National Bank, a corporation organized under the laws of the United States, by which, to secure an indebtedness of $700,000, evidenced by a promissory note dated March 12, 1932, made by said mortgagor and payable to said mortgagee, the mortgagor did mortgage to the mortgagee certain lands and premises in the Counties of Pershing, Humboldt and Elko, State of Nevada, therein specifically described, including the lands described in [82] the Bill of Complaint herein,

> "Together With all water, water rights, water applications and water permits, or privileges, connected with, belonging, appurtenant or incident to the lands hereby conveyed, or used in connection with all or any part of the said premises, or used or usable in connection therewith, and all dams, reservoirs and ditches, canals or other works for storage or carrying of water now owned by the mortgagor, or in which it now has, or may hereafter acquire any interest, and all applications now pending in the office of the State Engineer of the State of Nevada, for any and all waters to be used upon

any part or portion of the said lands, or used in connection therewith.

"Together With all and singular the tenements, hereditaments and appurtenances thereunto belonging, and in anywise appertaining, and the reversion and reversions, remainder and remainders, rents, issues and profits thereof."

No affidavit setting forth that said mortgage was made in good faith and without any design to hinder, delay or defraud creditors was appended or annexed to said mortgage.

PLAINTIFF'S EXHIBIT NO. 3

is a chattel mortgage dated March 12, 1932, duly executed, acknowledged and recorded, from said John G. Taylor, Inc. to The Reno National Bank as further security for the indebtedness and promissory note secured by the mortgage introduced as Exhibit No. 2, mortgaging certain described livestock, machinery, tools, and merchandise upon the lands described in said real property mortgage and the crops growing or to be grown thereon. Said chattel mortgage did not describe [83] therein any of the stock referred to in the Bill of Complaint.

By instruments dated, respectively, March 25, 1932 and April 23, 1932, duly executed, acknowledged and delivered by The Reno National Bank, said The Reno National Bank assigned to Reconstruction Finance Corporation the note and mortgages hereinabove described, and said assignments

were duly introduced in evidence as Plaintiff's Exhibits Nos. 4 and 5.

PLAINTIFF'S EXHIBIT NO. 6

is a certified copy of the Amended Articles of Incorporation of Humboldt Lovelock Irrigation Light & Power Company, duly executed on June 16, 1909, and acknowledged and filed as required by law, which Amended Articles of Incorporation provide:

"Know All Men By These Presents that we, the undersigned, citizens of the United States of America, desire to form a corporation under and by virtue of the laws of the State of Nevada, and do hereby associate ourselves together into a body corporate and politic, and to become incorporated for the transmission of the lawful business hereinafter set forth, and do hereby make, execute, acknowledge, sign and adopt, in duplicate, the following Articles of Incorporation, to wit:

"First: The corporate name of our said corpora- [84] tion is Humboldt Lovelock Irrigation Light & Power Company.

"Second: The object for which our said corporation is formed and incorporated is:

"1. To engage in the business of furnishing water for domestic and stock purposes and for the irrigation of lands; and the stockholders of our said corporation shall always be entitled, by virtue of being such stockholders, to a preferential use, over all other persons, natural or

artificial, of all water owned or possessed by our said corporation for the irrigation of lands owned or possessed by such stockholders; all water of our said corporation available for such irrigation purposes to be divided each season among the stockholders according to the respective rights of such stockholders, as hereinafter more fully stated; all water of our said corporation remaining after supplying the demand of the stockholders may be disposed of to other parties desiring the same.

"To acquire by purchase, grant, gift, devise, conveyance, condemnation, construction, location, appropriation, lease, sublease, mortgage, option, bond, assignment, transfer, agreement or otherwise, and to own, hold, store, impound, occupy, construct, develop, operate, maintain, make and generate electricity, for power, light and heat, use, and to furnish, sell, dispose of grant, bond, assign, exchange, lease, sub-lease, mortgage, pledge, or otherwise dispose of, in any lawful way or manner for money, labor, services or property, real, personal or mixed— [85]

"a. Land, any and all interests in land, buildings, reservoirs, dams, headgates, canals, ditches, flumes, pipe lines, machinery, apparatus, power plants, power, electricity, transmission lines for transmitting electricity or electrical energy for light, heat and power, water power, water, water rights, and any and all

rights to the use of water, leases, sub-leases, contracts, franchises, stock of this or other corporations, privileges, money, securities, licenses, contracts or options for the securing or disposing of any and all of the property, rights or privileges, or any interest therein, above enumerated;

"b. Any and all real, personal or mixed property whatever, and any and all interests therein, which may be necessary or incidental to enable our said corporation to carry on its operations named in these Amended Articles.

"2. To pay cash or issue full paid assessable stock in the payment for any and all property of whatsoever nature or kind authorized to be acquired, created, stored, [illegible]pounded, held, developed, used and operated by our said corporation.

"3. To otherwise do and transact any and all business and to do any and all things with any and all property it may acquire or control as it sees fit; and to do any and all other lawful things in connection with and necessary or incidental to enable our said corporation to carry on its operations as named in these Amended Articles.

"Third: The capital stock of our said corporation shall be One Hundred and Forty-five Thousand Nine Hundred and [86] fifty-three ($145,953.00) Dollars, and shall be divided into One Hundred and Forty-five Thousand Nine

Hundred and fifty-three (145,953) shares of the par value of One ($1.00) Dollar each, and said stock shall be full paid and assassable and shall be divided into two classes to be designated as Class A stock and Class B stock; ownership of stock of either Class shall entitle the holder thereof to receive water for irrigation purposes from said Company according to the respective rights of such stockholders; Class A stock shall have certain preferential rights over Class B stock, to wit: Class A stock shall be entitled to the preferential use of water from the Company of a maximum quantity of 10,000 acre feet each year, to be distributed pro rata if requested, for the irrigation of lands owned or irrigated by such stockholder, lying under or irrigated by means of water used through either the Irish American or Last Chance, Old Channel, Young or South West Ditch or ditches, situated in Lovelock Valley, Nevada; that such preferential use shall be expressly limited to such lands lying under said named ditches, and upon Class A stock being transferred to a transferee not a holder of Class A stock and not entitled to exercise such preferential use, Class B stock shall be issued to such transferee in lieu of the Class A stock so transferred; that, subject to such preferential right of Class A stock, Class A. stock and Class B stock shall be entitled and shall have the same rights to the use of water from the Company each year,

to be distributed [87] pro rata if requested, for the irrigation of lands owned or irrigated by such stockholder lying under or irrigated by means of water used through any ditch or ditch system in Lovelock Valley, Nevada; that the price to be charged any stockholder of Class A stock or Class B Stock for water furnished for irrigation purposes shall not exceed seventy-five cents per acre foot per season; and this limitation of a maximum charge shall not be increased by any amendment of these Articles, or in any way or manner whatsoever; provided, however, that the limitation of said maximum charge of seventy-five cents per acre foot per season shall not apply to any water, in excess of the pro rata share, received by any stockholder from the Company. The price to be charged any stockholder of any class of stock for water for irrigation purposes shall be fixed by the Board of Directors, subject to the limitations above designated, each season; that the total authorized issue of Class A stock shall be limited to and shall not exceed One Hundred Twenty Thousand Nine Hundred Fifty-three (120,953) shares, and the total authorized aggregate issue of Class A stock and Class B stock shall be limited to and shall not exceed One Hundred Forty-five Thousand Nine Hundred Fifty-three (145,953) shares.

"The original amount of subscribed capital stock with which it commenced business was

Two Thousand ($2,000) Dollars, the original amount actually subscribed was Two Thousand ($2000) Dollars, and the original amount actually [88] subscribed was Two Thousand ($2000) Dollars, and the original amount actually paid up was One Thousand ($1000) Dollars. Under this amendment all stock now outstanding and amounting to One Hundred Forty-five Thousand Nine Hundred Fifty-three (145,953) shares, of the par value of $1.00 per share fully paid and assessable, shall be surrendered and cancelled, and for each share of stock so surrendered for cancellation there shall be issued and delivered one share of Class A stock to every stockholder except Lovelock Land & Development Company, and to said Lovelock Land & Development Company for each of the twenty-five thousand (25,000) shares held by it so surrendered for cancellation, there shall be issued and delivered one share of Class B stock.

"Fourth: The term of existence of our said corporation shall be unlimited.

"Fifth: The affairs and management of our said corporation are to be under the control of a Board of Directors, said Board of Directors to consist of five persons.

"Sixth: The Board of Directors of our said corporation shall have power to do and perform all acts not in conflict with the laws of the State of Nevada, which our said corporation has power to do under and by virtue of these

Amended Articles of Incorporation and the laws of the State of Nevada, and shall have power to authorize the President and Secretary of the corporation to make, execute, acknowledge and deliver all documents of whatsoever kind or nature, with [89] the seal of the corporation affixed thereto, for the purpose of carrying into effect all the powers and privileges of the corporation as aforesaid. Said Board of Directors shall likewise have power to make and adopt from time to time such prudential by-laws as they may deem proper for the management and disposition of the stock and business affairs of this corporation, not inconsistent with the laws of this State and the provisions of these Amended Articles of Incorporation, and prescribing the duties of officers, artificers and servants that may be employed, for the appointment of all officers, and for carrying on all kinds of business within the objects and purposes of this corporation; and to fill vacancies which may exist in said Board of Directors by reason of the death, resignation or other incapacity of any director to serve; said appointee or appointees to hold office until the next election of directors.

"Seventh: The principal place or office of business of our said corporation, within the State of Nevada, shall be located in Lovelock Mercantile Company's building on the southwest corner of Fourth and C Streets in the

Town of Lovelock, County of Humboldt, State of Nevada.

"Our said corporation assumes to itself and shall and does possess all the rights, powers, privileges and franchises granted or conferred upon corporations by the laws of the State of Nevada, except as hereinabove limited."

PLAINTIFF'S EXHIBIT NO. 7

is a certified copy of the Articles of Incorporation of Young Ditch Company, duly executed on August 14, 1915, and [90] acknowledged and filed as required by law, which Articles of Incorporation provide:

"For the purpose of forming a corporation under the laws of the State of Nevada, the undersigned, whose names appear in full herein, hereby certify and agree as follows:

"Article I. The name of this corporation is Young Ditch Company.

"Article II. The location of the principal place of business of the corporation in the State of Nevada, is at the office of John G. Taylor, at the Town of Lovelock, County of Humboldt, State of Nevada, and all regular meeting of the Stockholders, and all regular meetings of the Directors, must be held at such office, but the by-laws may provide, for the establishment of branch offices elsewhere either in, or outside of the State of Nevada, and provide for the holding of special meeting of the Directors, or ad-

journed sessions of regular meetings at any such office.

"Article III. The period of existence of this corporation is unlimited.

"Article IV. In furtherance, and not in limitation of the powers now, or hereafter conferred upon corporations by the laws of the State of Nevada, or any other State or Territory in which the corporation may do business, the corporation shall generally have the following powers, and is incorporated for the following general purposes.

"(1) To acquire by, purchase, or otherwise, to sell, lease, contract, exchange, or in any manner secure lands for dam, ditch and reservoir site, together with rights of way and ease- [91] ments, and in any lawful manner dispose of the same in whole or in part.

"(2) To acquire, own and in any lawful manner dispose of water rights and privileges, of any and every kind, and while the owner, or entitled to the possession of any such rights, to in any lawful manner control or handle the same.

"(3) To issue, sell, or otherwise dispose of bonds, debentures, promissory notes and other evidences of indebtedness necessary to raise money to conduct the business of the corporation; and to secure the payment of any such obligations, by properly executed mortgages, deeds of trust, or other instruments in writing necessary and proper for that purpose.

"(4) To enter into, make and perform contracts of any kind, with any person, firm, corporation or association, county, city, state, territory, or government as fully to all intents and purposes as natural persons might or could do.

"(5) Generally without limitation or restriction, to do any or all things herein set forth, to the same extent as natural persons might or could do, as principal, agent, or contractor or otherwise, with all the powers conferred by, or not in conflict with the laws of the State of Nevada, or any other place where the corporation may do business.

"Article V. The authorized capital stock of the Corporation is Sixty Thousand ($60,000) Dollars, divided into 6,000 shares, of the par value of Ten ($10.) Dollars each, and the amount of subscribed stock with which it will commence business is Three Thousand ($3,000) Dollars. [92]

"Article VI. The names of the original subscribers, the incorporators of this company, together with the number of shares subscribed by them respectively, are as follows:

John G. Taylor	100 shares
John Holmstrom	100 "
H. P. Kruse	100 "
Unsubscribed	5700 "
Total	6,000 "

"The Board of Directors shall have power to accept payments, at par, for any of the capital stock of the corporation, in money or property sold, to the corporation, taken at the fair cash value thereof, and any such stock, so issued, shall be fully paid, and so issued, but shall nevertheless be subject to assessment as herein provided. In the absence of actual fraud, the judgment of the Board of Directors as to the value of any such property shall be conclusive.

"Article VII. The members of the governing Board shall be styled Directors, and shall be five in number. They shall be elected in the manner, and for the term prescribed by the by-laws and the Statutes of Nevada. All other officers shall be chosen by the Board of Directors in the manner prescribed by the bylaws.

"Article VIII. The stockholders shall have power to enact any and all by-laws necessary for the government of the corporation, or the conduct of the business of the corporation, not inconsistent with these Articles of Incorporation, or with the laws of the State of Nevada, or the United States, and to amend or repeal the same at pleasure. [93]

"Article IX. The capital stock of this corporation shall be subject to assessment, and sale for nonpayment thereof, for the purposes of paying the debts of, or purchasing property for the corporation, in manner and form and

to the extent prescribed by the by-laws and the laws of the State of Nevada.

"Article X. The private property of the stockholders or incorporators and stockholders shall not be liable for the debts of the corporation."

PLAINTIFF'S EXHIBIT NO. 8.

is a certified copy of the Articles of Incorporation of Old Channel Ditch Company, duly executed on November 23, 1929, and acknowledged and filed as required by law, which Articles of Incorporation provide:

"Know All Men By These Presents: That we, the undersigned, who are citizens of the State of Nevada, have this day voluntarily associated ourselves together for the purpose of forming a corporation under the laws of the State of Nevada—and we hereby certify:—

"First: That the name of the said corporation shall be the 'Old Channel Ditch Company.'

"Second: That the purpose and object for which this Company is formed is to purchase, acquire, sell, convey, lease, mortgage and generally deal and operate in land, premises, water and water rights, to build, *construct* and maintain Dams, Reservoirs, Ditches, Flumes and *Acqueducts*, for the storing, carrying and conducting of water for irrigation and other purposes: to sell and lease water and the [94] use thereof for such purposes, and generally to deal and operate in land, premises, water and water

rights, and the acquiring and disposal of the same, and the use thereof for irrigation and other purposes:——

"Third: That the place where the principle business of said corporation is to be transacted is in the town of Lovelock, Humboldt County, State of Nevada:

"Fourth: That the term for which said Corporation is to exist is Forty (40-years from and after the date of this Incorporation:

"Fifth: That the number of Trustees of said Corporation shall be Seven (7), and that the names and residences of the Trustees who shall manage the affairs of the Corporation for the first six months and shall serve until the election and qualification of their successors in said office are as follows to wit:

Name	Office	Residence
W. C. Pitt	President	Lovelock, Nevada.
John G. Taylor	Vice-President	Lovelock, Nevada.
B. F. Lynip	Secretary	Lovelock, Nevada.
Hans C. Damm	Treasurer	Lovelock, Nevada.
Hiram Stoker	Trustee	Lovelock, Nevada.
George Pitt	Trustee	Lovelock, Nevada,
J. T. Hauskins	Trustee	Lovelock, Nevada."

PLAINTIFF'S EXHIBIT NO. 9

is a certified copy of the Articles of Incorporation of Union Canal Ditch Company, duly executed on September 21, 1910, and acknowledged and filed as

required by law, which Articles of Incorporation provide: [95]

"For the purpose of forming a corporation under the laws of the State of Nevada, the undersigned, whose names appear in full herein, hereby certify and agree as follows:

"Article I. The name of this corporation is Union Canal Ditch Company.

"Article II. The location of the principal place of business of the corporation in the State of Nevada, is at the office of the First National Bank, at the Town of Lovelock, County of Humboldt, State of Nevada, and all regular meeting of the stockholders, and all regular meetings of the Directors, must be held at such office, but the by-laws may provide, for the establishment of branch offices elsewhere either in, or outside the State of Nevada, and provide for the holding of special meeting *odf* the directors, or adjourned sessions of regular meetings at any such office.

"Article III. The period of existence of this corporation is unlimited.

"Article IV. In furtherance, and not in limitation of the powers now, or hereafter conferred upon corporations by the laws of the State of Nevada, or any other State or Territory in which the corporation may do business, the corporation shall generally have the following powers, and is incorporated for the following general purposes.

"(1) To acquire by purchase, or otherwise, to sell, lease, contract, exchange, or in any manner secure lands for dam, ditch and reservoir sites, together with rights of way and easements, and in any lawful manner dispose of the same in [96] whole or in part.

"(2) To acquire, own and in any lawful manner dispose of water rights and privileges, of any and every kind, and while the owner, or entitled to the possession of any such rights, to in any lawful manner control or handle the same.

"(3) To issue, sell, or otherwise dispose of bonds, debentures, promissory notes and other evidences of *indebtednaess* necessary to raise money to conduct the business of the corporation; and to secure the payment of any such obligations, by properly executed mortgages, deeds of trust, or other instruments in writing necessary and proper for that purpose.

"(4) To enter into, make and perform contracts of any kind, with any person, firm, corporation or association, county, city, state, territory, or government as fully to all intents and purposes as natural persons might or could do.

"(5) Generally without limitation or restriction, to do any or all things herein set forth, to the same extent as natural persons might or could do, as principal, agent, or contractor or

otherwise, with all the powers conferred by, or not in conflict with the laws of the State of Nevada, or any other place where the corporation may do business.

"Article V. The authorized capital stock of the corporation is Eighty Thousand ($80,000.) Dollars, divided into 8,000 shares, of the face or par value of Ten ($10.) Dollars each, and the amount of subscribed stock with which it will commence business is Five Thousand ($5000) Dollars. [97]

"Article VI. The names of the original subscribers, the incorporators of this company, together with the number of shares subscribed by them respectively, are as follows:

Peter Anker	100	shares
Andrew Westfall	100	"
Hans Jensen	100	"
Ingvert Hanson	100	"
Conrad Mortensen	100	"
Unsubscribed	7500	"
Total	8000	"

"The board of directors shall have power to accept payment, at par, for any of the capital stock of the corporation, in money paid or property sold, to the corporation, taken at the fair value thereof, and any such stock, so issued, shall be fully paid, and so issued, but shall

nevertheless be subject to assessment as herein provided. In the absence of actual fraud, the judgment of the board of directors as to the value of any such property shall be conclusive.

"Article VII. The members of the governing board shall be styled directors, and shall be five in number. They shall be elected in the manner, and for the term prescribed by the by-laws and the Statutes of Nevada. All other officers shall be chosen by the board of directors in the manner prescribed by the by-laws.

"Article VIII. The stockholders shall have power to enact any and all by-laws necessary for the government of the corporation, or the conduct of the business of the corporation, not inconsistent with these articles of incorporation, or with the laws of the State of Nevada, or the United States, and to amend or repeal the same at pleasure. [98]

"Article IX. The capital stock of this corporation shall be subject to assessment, and sale for nonpayment thereof, for the purpose of paying the debts of, or purchasing property for the corporation, in manner and form, and to the extent prescribed by the by-laws and the laws of the State of Nevada.

"Article X. The private property of the stockholders or incorporators and stockholders shall not be liable for the debts of the corporation." [99]

PLAINTIFF'S EXHIBIT 10

is a certified copy of a decree dated October 20, 1931, rendered by the Sixth Judicial District Court of the State of Nevada, in and for the County of Humboldt, in Case No. 2804, entitled "In the Matter of the Determination of the Relative Rights of Claimants and Appropriators of the Waters of the Humboldt River Stream System and Its Tributaries," wherein the rights of claimants or appropriators of the waters of the Humboldt River Stream System were determined by said court, which decree, so far as here involved, determines:

> "That the names of claimants or appropriators or successors of the waters of the Humboldt River stream system and its tributaries diverting waters from said Humboldt River stream system for beneficial use, the source of water supply, the means by which the water is secured from the source and applied to beneficial use, the year of priority, the cultured acreage of harvest crop, meadow pasture and diversified pasture, the legal subdivisions, section, township and range, length of season and duty of water for each of said claimants or appropriators is hereby adjudged and decreed as follows, to wit:" (Here are listed the respective priorities and rights of the various parties, including certain rights and priorities appurtenant to the lands described in the complaint herein, of which the following is typical but not exclusive: [100]

	Culture Acres			Location				Duty of Water		
Priority	Harvest	Meadow Pasture	Diversified Pasture	Subdivision	Sec.	Tp.	R.	Length of Season	C.F.S.	Acre Feet

Claimant—JOHN G. TAYLOR
Source—Humboldt River.
Ditch—Old Channel in conjunction with Young Ditch.

1888*	20.00	....	....	N½	3	27	31	3-15- 9-15	.163	60.00
1888*	60.00	....	....	N½	3	27	31	3-15- 9-15	.488	180.00
1888*	190.00	....	....	S½	3	27	31	3-15- 9-15	1.545	570.00
1888*	66.10	....	....	N½	3	27	31	3-15- 9-15	.537	198.30
1888*	388.75	....	....		10	27	31	3-15- 9-15	3.159	1166.25

*As of May.

Source—Humboldt River.
Ditch—Irish-American, in conjunction with Union Canal.

1887	136.05	....	....	SW¼	22	27	31	3-15- 9-15	1.106	408.15)

Neither the Humboldt Lovelock Irrigation Light & Power Company, Young Ditch Company, Union Canal Ditch Company, nor Old Channel Ditch Company are by said decree found or determined to have rights in or to the waters of said Humboldt River stream system, except that Union Canal Ditch Company was found to have certain rights in respect of lands not here involved, which rights are those referred to in the testimony of A. Jahn.

Said decree further provides: [101]

"It Is Further Ordered, Adjudged and Decreed that except such persons as may have acquired rights to the use of the water of Humboldt River stream system and its tributaries

granted under applications to the State Engineer under and by virtue of the provisions of the statute, no person other than the parties named herein have or claim any interest in or to said water or in or to the use of said water or any part thereof.

"That the order of the rights of the respective appropriators of the waters of said stream and its tributaries, and in which order they are entitled to divert and use the said water, shall be and is according to the date of the relative priority of the right as herein set forth and determined, and the first in order of time according to the date of relative priority shall be and is the first in order of right, and so on, down to the date of the latest priority, and those having prior rights are entitled to divert and use the waters of said stream and its tributaries when necessary for the beneficial use in connection with the irrigation of their respective lands, or other useful and beneficial purposes for which they are decreed a right of use, at all times and against those having subsequent rights, without let or hindrance, and whenever the water is not required by the appropriator having a prior right to its use for the purpose for which said water was appropriated, he must and shall permit it to flow down in the natural channel of the stream as it was wont to flow in its natural course, without hindrance or diversion thereof, and those having subsequent rights

are entitled to the use of such water and to divert the same to [102] the extent of their rights of appropriations, according to the order of their priority rights; and at all times the waters diverted shall be beneficially, economically and reasonably used without waste by those having a right to do so by reason of the priority of their rights.

"That the rights of appropriation hereby confirmed are appurtenant to the lands herein described for irrigation purposes, and the right of use of the waters of said stream and its tributaries by virtue of such rights of appropriation are limited and confined to the irrigation of the lands described herein to the extent of said lands as herein set forth, and the priorities herein confirmed confer no right of use of the waters of said stream, and its tributaries, on the lands other than those specified tracts to which such rights of appropriation are herein set forth as appurtenant. The right of a water user to change the place of use of a vested water right, in the manner, now or hereafter, provided or permitted by law shall not be prohibited or affected by this decree." [103]

WILLIAM WOODBURN,

a witness called on behalf of plaintiff, testified:

I am an attorney at law, and in 1932 represented The Reno National Bank in connection with a mort-

(Testimony of William Woodburn.)
gage taken by that bank from John G. Taylor, Inc. I was also at that time a director of the bank.

Prior to the execution of the mortgage I had a conversation with Mr. Taylor, president of John G. Taylor, Inc., at which Mr. Randolph, secretary of that company, was also present. It was made plain to Mr. Taylor, and he expressed himself as agreeable, that all property of every kind, nature and description owned by John G. Taylor, Inc. was intended to be given to the bank as security for the note secured by said mortgage. I do not recall whether anything was specifically said about the water rights incident to or appurtenant to the lands. I was familiar in a general way with the property owned by Mr. Taylor and knew that it was irrigated. It was the intention of both parties to the transaction that everything that John G. Taylor, Inc. owned was intended to go as security for the note.

ALLARD A. CALKINS,

a witness called on behalf of plaintiff, testified:

I am Manager of the San Francisco Loan Agency of Reconstruction Finance Corporation, and have been since [104] June 1, 1932. I was Assistant Manager from the opening of that agency from about February 8, 1932, until I became Manager. I had charge of the transactions with The Reno

(Testimony of Allard A. Calkins.)

National Bank at all times, both before and after becoming Manager.

I am familiar with the $700,000 note of John G. Taylor, Inc. to The Reno National Bank and the mortgages securing the same. The Reconstruction Finance Corporation advanced to The Reno National Bank $1,120,000 on April 26 and April 27, 1932, secured in part by assignment of the John G. Taylor, Inc. note and mortgages. Prior to such advances being made I had discussions with Mr. Sheehan, vice-president of The Reno National Bank, with respect of the properties covered by said mortgages. These transactions occurred between February 10 and March 4, 1932. I was told by Mr. Sheehan that all the property belonging to John G. Taylor, Inc. was covered by said mortgages. I also received a copy of a statement as of December 31, 1931, of John G. Taylor, Inc., certified by Mr. Wilcox, of The Reno National Bank, which statement lists, among other properties, 3,000 acres of land at Lovelock, Pershing County, Nevada, valued at $50 per acre, and contains the statement with reference thereto that "Each of these ranches are equipped with good dwellings, bunk houses, barns, sheds, corrals, blacksmith shops and plenty of water."

The subject of these properties was discussed in considerable detail, as there was not time for the [105] Reconstruction Finance Corporation to have an appraisal of the property made. The Lovelock

(Testimony of Allard A. Calkins.)

properties were pointed out as the most desirable properties held by John G. Taylor, Inc. largely because of the quantity of hay and grain raised thereon, their use as winter feeding ground, particularly for sheep, and there were detailed statements as to water, volunteered by Mr. Sheehan or made in response to my questions.

No mention was made in these discussions of any stock of any companies, but the Lovelock properties were named as being of particular value because of the water they had, and the source of water was named as the reservoir built by Mr. Pitt and Mr. Taylor, and of which Mr. Taylor owned the major part. The land would always be fully watered, and that fact was stressed because we knew the land without the water was worth nothing. On behalf of Reconstruction Finance Corporation I would not have approved the loan if I had believed that no water rights went with the land.

No mention of any water stocks was made in any of my discussions with Mr. Sheehan, and I made no request for hypothecation of any shares of any stocks. Mr. Sheehan made no such demand or request in my presence. I did not demand any such pledge because I didn't know of the existence of such stocks and had never heard of those companies, but I had heard of the water rights. [106]

Prior to disbursement by Reconstruction Finance Corporation of the moneys referred to no investi-

(Testimony of Allard A. Calkins.)

gation had been made as to whether John G. Taylor was the owner of stocks in any of the water companies here involved. I did not know of the organization of such water companies and was not told of their existence by Mr. Sheehan. I first heard of their existence late in 1933, or early in 1934, in connection with other litigation instituted by the Receiver of the Bank of Nevada Savings & Trust Company approximately one year after acceptance of the assignment of the mortgages of John G. Taylor, Inc. If I had known of the existence of the water companies I would have insisted on hypothecation of their shares in order to preclude any doubts and because we felt that we ought to have everything and every scrap of paper owned by John G. Taylor affecting the land, without evaluating it.

JOHN V. MUELLER,

a witness called on behalf of plaintiff, testified:

I reside at Reno, Nevada, and am an engineer by profession. I am familiar with lands in Lovelock Valley, and particularly those which belong to John G. Taylor and John G. Taylor, Inc., described in the complaint herein and in the deeds and mortgages in evidence herein (Exhibits 1 and 2). Those lands are to some extent irrigated, the source being the Humboldt River. Those lands are irrigated through the Irish American, the South West, Young, and Old [107] Channel ditches.

(Testimony of John V. Mueller.)

The lands referred to are also described in Certificates 2130 and 2131 issued by the State Engineer of Nevada September 18, 1935, for the appropriation of water, certified copies of which certificates were introduced in evidence as Plaintiff's Exhibits 11 and 12, and which respectively read as follows:

PLAINTIFF'S EXHIBIT NO. 11

"Application No. 1098 Certificate Record
No. 2130 Book 7 Page 2130
The State of Nevada
Certificate of Appropriation of Water

"Whereas, W. C. Pitt for H. L. I. L. & P. Company has presented to the State Engineer of the State of Nevada Proof of Application of Water to Beneficial Use, from Humboldt River through H. L. I. L. & P. Co. canal and Reservoirs No's 1 & 2 for Irrigation stock-watering and domestic purposes. The point of diversion of water from the source is as follows: Approximately the center of the NW¼ of Section 29, T. 33 N., R. 35 E., M. D. B. & M. situated in Pershing County, State of Nevada.

"Now Know Ye, That the State Engineer, under the provisions of Section 29, Chapter 18, Statutes of 1907 has determined the date, source, purpose and amount of such appropriation, together with the place to which such water is appurtenant, as follows:

(Testimony of John V. Mueller.)

Name of appropriator—Humboldt-Lovelock Irrigation, Light & Power Co.

Post-office address—Lovelock, Nevada.

Amount of appropriation—°° 300 c.f.s. or 20,200 acre feet per annum of flood waters.

Period of use, from March 15th to September 15th of each year. [108]

"Date of priority of appropriation, August 21, 1908.

Description of works of diversion and storage: Water is diverted by means of concrete dam and headgates and conveyed through 12½ miles of feeder canal to Reservoir No. 1 with capacity of 17,700 acre feet and Reservoir No. 2 with a capacity of 2500 acre feet. Water from the reservoirs is released through control gates at the reservoirs into the main channel of the Humboldt River and used for irrigation through the Young, Old Channel, Lovelock Land and Development Co., Irish-American and South West ditches.

°° The stored waters as granted by this certificate are to be used only to supply any deficiency in the irrigation of vested rights lands herein listed as irrigated by direct diversion from the Humboldt River and in no event shall such combined use exceed any duty of water decreed to such lands.

(See attached supplemental sheet for description of land to which water is appurtenant.)

(Testimony of John V. Mueller.)

"The right to water hereby determined is limited to the amount which can be beneficially used, not to exceed the amount above specified, and the use is restricted to the place where acquired and to the purpose for which acquired.

In Testimony Whereof, I Alfred Merritt Smith, State Engineer of Nevada, have hereunto set my hand and the seal of my office, this 18th day of September, A. D. 1935.

Recorded Sept. 21, 1935, Bk. #1, Page 26.

Pershing County Records.

[Seal] ALFRED MERRITT SMITH
State Engineer." [109]

(Supplemental sheet attached to
Certificate No. 2130)

"Description of vested right lands to which water through Old Channel Dam and Ditch System is appurtenant:

Portions of Sections 9, 10, 11, 12, 13, 14, 15, 16, 21, 22, 23, 24, and 27 of T. 27 N., R. 31 E., M. D. B. & M., and Section 18, T. 27 N., R. 32 E., M. D. B. & M.

"Description of vested right lands to which water through Young Ditch System is appurtenant:

Portions of Sections 1, 2, 3, 4, 10, 11, 12, of T. 27 N., R. 31 E., M. D. B. & M.; Section 34, T. 28 N., R. 31 E., M. D. B. & M.; Sections 6 and 7, T. 27 N., R. 32 E., M. D. B. & M.; and Sections 30 and 31 of T. 28 N., R. 32 E., M. D. B. & M.

(Testimony of John V. Mueller.)

"Description of vested right lands to which water through the Southwest Ditch is appurtenant:

Portions of Sections 27 and 28 of T. 27 N., R. 31 E., M. D. B. & M.

"Description of vested right lands to which water through Irish-American Ditch is appurtenant:

Portions of Sections 21, 22, 27, 28, 29, 30 and 31 of T. 27 N., R. 31 E., M. D. B. & M.; and Section 6 of T. 26 N., R. 31 E., M. D. B. & M.

"Description of vested right lands to which water through Lovelock Land and Development Company's Ditch System is appurtenant:

Portions of Sections 7, 8, and 16, T. 25 N., R. 31 E., M. D. B. & M.; and Section 12, T. 25 N., R. 30 E., M. D. B. & M."

PLAINTIFF'S EXHIBIT NO. 12

"Application No. 1948 Certificate Record
No. 2131 Book 7 Page 2131
The State of Nevada
Certificate of Appropriation of Water

"Whereas, Geo. C. Stoker, Pres., H. L. I. L. & P. Co. has [110] "presented to the State Engineer of the State of Nevada Proof of Application of Water to Beneficial Use, from Humboldt River through H. L. I. L. & P. Co.

(Testimony of John V. Mueller.)

canal and reservoirs No's 1 & 2 for Irrigation purposes. The point of diversion of water from the source is as follows: Approximately the center of the NW¼ of Section 29, T. 33 N., R. 35 E., M. D. B. & M. situated in Pershing County, State of Nevada.

"Now Know Ye, That the State Engineer, under the provisions of Section 29, Chapter 18, Statutes of 1907 has determined the date, source, purpose and amount of such appropriation, together with the place to which such water is appurtenant, as follows:

Name of appropriator—Humboldt-Lovelock Irrigation, Light & Power Co.

Post-office address—Lovelock, Nevada.

Amount of appropriation—°° 450 c.f.s. or 29,570 acre feet per annum of flood waters.

Period of use, from March 15th to September 15th of each year.

Date of priority of appropriation—February 10, 1911.

"Description of °°Note: This certificate covers additional and supplementary rights to storage of flood and unappropriated waters of the Humboldt River to those storage rights granted under Certificate No. 2130 issued under permit No. 1098. This additional storage has been created by enlargement of feeder canal and by raising levees of reservoirs No's 1 & 2 so as to provide maximum storage capacities

(Testimony of John V. Mueller.)

of 28,970 acre feet and 20,800 acre feet respectively for said reservoirs. The stored waters under this certificate are to be used only [111] to supply any deficiency in the existing water rights on lands irrigated by direct diversion from the Humboldt River as described on supplemental sheet and in no event shall such combined use exceed the duty specified for such lands:

(See supplemental sheets for description of land to which water is appurtenant.)

"The right to water hereby determined is limited to the amount which can be beneficially used, not to exceed the amount above specified, and the use is restricted to the place where acquired and to the purpose for which acquired.

"In Testimony Whereof, I Alfred Merritt Smith, State Engineer of Nevada, have hereunto set my hand and the seal of my office, this 18th day of September, A. D. 1935.

[Seal] ALFRED MERRITT SMITH
State Engineer."

"Recorded Sept. 21, 1935, Bk. #1, Page 78. Pershing County Records. Water Certificates.

(Testimony of John V. Mueller.)

(Supplemental sheets attached to Certificate No. 2131)

"Description of Land to Which Water Is Appurtenant

"Township	Range	Sec.	Subdivision	Acres
25 N.	30 E.	11		626.00
		12		633.40
25 N.	31 E.	2	W½ SW¼	70.00
		4	W½ NE¼	76.35
		4	W½, W½ SE¼	366.00
		6	N½ NE¼, SE¼ NE¼	60.00
		7	NE¼, NW¼ NW¼, S½ NW¼, S½	588.25
		7	NE¼ NW¼	39.25
		8	NE¼	150.00
		8	NW¼	140.25
		8	S½	305.00
		9	N½	200.00
		10	W½ NE¼	70.00
		16	NE¼, NW¼ SE¼, NE¼ SW¼, SE½ SW¼	220.00
				[112]
		16	NW¼	150.00
		18		611.30
		19	NE¼	155.00
		19	NW¼, S½	460.00
		20	SE½ NE¼, NW¼, N½ S½	360.00
26 N.	31 E.	12	N½ NE¼	77.00
		12	S½ NE¼	80.00
		12	N½ SE¼	80.00
		12	S½ SE¼	80.00
		12	W½	271.55
		20	E½ SE¼	57.05
		20	W½ SE¼, E½ SW¼	55.10
		21	W½	242.70
		21	W½ E½	138.50
		22	N½, SW¼, W½ SE¼, NE¼ SE¼	526.45
		28	NE¼, N½ SE¼	184.75

estimony of John V. Mueller.)

ship	Range	Sec.	Subdivision	Acres
		28	SE½ SE¼	69.08
		29	SW¼ NE¼, E½ NW¼	79.40
		29	SE¼ SE¼	11.40
		30	E½ NE¼, NE¼ SE¼	30.00
		32	E½	271.30
		32	SW¼	135.25
		33	E½ NE¼	72.40
		33	W½ NE¼	69.60
		33	E½ NW¼	55.05
		33	W½ NW¼	66.40
		34	N½	225.00
		34	S½ N½	45.00
		34	SE¼	141.75
		34	SW¼	148.70
		35	S½ NE¼, SE¼	172.68
		35	S½ NW¼, SW¼	161.60
N.	31 E.	1	E½ E½	71.55
		1	W½ E½	67.15
		1	E½ W½	63.75
		1	W½ W½	20.60
		2	S½, S½ N½	253.30
		3		336.10
		4	E½	101.05
		9	E½, E½ W½	340.95
		10	N½, SW¼ N. of O. C. Ditch	388.75
		10	E½ SE¼	74.00
		10	W½ SE¼	70.95
		10	SW¼ S. of O. C. Ditch	67.00
		11	N½ NE¼	19.00
		11	W½, N½ SE¼	295.51
				[113]
N.	31 E.	11	S½ SE¼	75.65
		12	NE¼	147.51
		12	N½ NW¼	66.85
		12	SE¼	155.00
		12	E½ SW¼	74.30
		12	W½ SW¼	74.30

(Testimony of John V. Mueller.)

Township	Range	Sec.	Subdivision	Acres
		13	NE¼ E. of Railroad	55.50
		13	NE¼ W. of " N½ NW¼	143.50
		13	E½ SW¼ W. of " S½ NW¼	99.50
		13	E½ SW¼ E. of " SE¼	152.98
		13	W½ SW¼	66.50
		14	E½ NE¼	73.35
		14	W½ NE¼, NW¼	224.70
		14	S½	273.65
		15		572.25
		16	E½, E½ W½	303.44
		21	NE¼, E½ NW¼, N½ SE¼, SE¼ SE¼	190.95
		22	NE¼	145.05
		22	NW¼	153.00
		22	SE¼	94.58
		22	SW¼	136.05
		23	NE¼, NW¼ SE¼ W. of Railroad	115.35
		23	NW¼	127.50
		23	SW¼	137.45
		24	NW¼ E. of Railroad	93.13
		24	NW¼ NW¼ W. of Railroad	2.75
		26	N½ NW¼ W. of "	32.89
		27	W½ NE¼, NW¼	179.70
		27	W½ SE¼	50.00
		27	SW¼	136.40
		28	E½ NE¼	73.14
		28	W½ NE¼	70.75
		28	NW¼ E. of Slough	90.00
		28	NW¼ W. of "	57.76
		28	S½	217.40
		29	NE¼, S½ NW¼, SW¼	238.95
		29	SE¼	133.95
		30	E½ SE¼	39.00
		31	E½ NE¼	33.45
		32	NE½ NE¼	51.20
		32	NW¼, N½ SW¼	80.92
		33	NW¼	127.80
		35	E½, E½ W½	364.34
		36		369.60

(Testimony of John V. Mueller.)

Township	Range	Sec.	Subdivision	Acres
27 N.	32 E.	6	E½, E½ of E½ of W½	179.50
		7	NW¼	150.95
		7	W½ SE¼	65.40
		7	SW¼ W. of Railroad	54.63
		18	E½ NW¼	81.13
		18	NW¼ NW¼	35.00
		18	SW¼ NW¼	35.60
		18	NW¼ SW¼	35.00
28 N.	31 E.	33	E½ SE¼	26.00
		34	NE¼, S½	411.02
28 N.	32 E.	31	SE¼	155.00
			Total	18,340.44"

[114]

The so-called Taylor lands described in said certificates aggregate a little over 2,000 acres. I have been familiar with that property for over twenty years. Alfalfa and grain are raised on that property. I have made particular examination of this property from time to time and am acquainted with agricultural conditions generally in the State of Nevada. Without irrigation these lands would be valuable only for grazing land and worth from $1.25 to $2.50 per acre. As irrigated lands they are worth from $50 to $100 per acre. These answers would apply both as to the year 1932 and as of the present time.

I am familiar with the decree adjudicating water rights (Exhibit 10), and it is my opinion that without the use of the Humboldt Lovelock Irrigation Light & Power Company facilities the Taylor lands, relying only on the natural flow of the Humboldt

(Testimony of John V. Mueller.)
River, would not receive a sufficient amount of water to produce crops, and that the value of the lands would be approximately half of what it is with the Humboldt Lovelock Irrigation Light & Power Company reservoir rights.

The Taylor lands do not actually adjoin the Humboldt River. Water is conveyed to those lands through the Young, Old Channel, South West, and Irish American, also known as Last Chance, ditches. During the twenty years I have been familiar with that property it has not received irrigation water other than through these ditches.

The first ditch that irrigates lands in the Lovelock Valley and any of the John G. Taylor lands, is the Young Ditch. Water is diverted into the Young Ditch by means of a dam in the Humboldt River. The next point of diversion is what is commonly known as the Old [115] Channel Dam into a ditch which, for a distance, carries the Old Channel Ditch water, the South West Ditch water, and the Union Canal water. The Old Channel Ditch leaves this common diversion above the South West Ditch and where the South West Ditch takes off and continues on is known as the Union Canal and takes care of the Union Canal water. When water from the Humboldt from an upper reservoir, is turned into the river at the opening of the reservoir, it is carried down the Humboldt River and distributed to the Young Ditch, Old Channel, South West and Irish-American. The Irish-American has a

(Testimony of John V. Mueller.)

separate dam in the Humboldt channel, the first one below the Old Channel dam.

The State Engineer has regulated and directed the diversion of water into these ditches for the past six or eight years. The water when taken through these ditches and on to the Taylor lands is devoted to beneficial use thereon and has been since my acquaintance with the property.

I know that the Humboldt Lovelock Irrigation Light & Power Company, Young Ditch Company and Old Channel Ditch Company are corporations. I know that the Irish-American Ditch is not incorporated. It is my opinion that the Humboldt Lovelock Irrigation Light & Power Company have water rights which are put to beneficial use on the Taylor lands, which are those evidenced by Certificates 2130 and 2131. The Young Ditch Company and Old Channel Ditch Company [116] merely own ditches and, so far as I know, have no water rights. Their ditches are used for the transfer and conveyance of water to the Taylor lands, and there is no other means for irrigation of those lands except through those ditches. As representative of the State Engineer I participated in the division of water through these ditches, and in the course of such work I would confer with some individual designated as in charge of the distribution in the ditches by these companies. I dealt only with these parties in diverting water to the ditches, and after it reached the ditches I paid no attention to it. The

(Testimony of John V. Mueller.)

only basis I had to distribute water was in accordance with the determination of the State Engineer prior to the entry of the so-called Bartlett decree. The State Engineer's order of determination assigned the water not to the ditch companies but to the individual property owners, and in allowing water to be diverted I based my decision on the finding as to the rights of such individuals.

In distributing water pursuant to the State Engineer's order and determination I determined the amount and priority of the individual land owners served by the ditches and allotted water in accordance therewith, and some individual appointed by the ditch companies attended to actual distribution among the users. The amount allotted to the respective ditches was determined by the determination of the rights of individuals owning property served thereby. In carrying out my duties I treated the ditch companies as agencies and instrumentalities through which [117] the individual land owners received the water to which they were entitled.

ARCHIE MILLER,

a witness called on behalf of plaintiff, testified:

I am Supervising Water Commissioner of the Humboldt River and have held that position about six years. My duties are to superintend the distri-

(Testimony of Archie Miller.)
bution of the water from the Humboldt River to lands in the Lovelock Valley. My office is subordinate to that of the State Engineer.

Prior to 1930 we were guided by the order and determination of the State Engineer determining the rights and priorities of appropriators in the district. Since 1930 we have operated under the so-called Bartlett decree (Exhibit 10).

I am familiar with the various companies previously mentioned. In making allocations of water I have not had occasion to interview the executives of those companies. Prior to 1928 the water commissioner in Lovelock Valley, in addition to the duty of diverting water from the river into the ditches, also handled the reservoir water, and there was quite a bit of complaint. In 1928 the reservoir company employed their own man and the State Engineer had nothing to do with the reservoir water other than to see that it got into the ditch. The State Engineer's office made no effort to interfere with the representative of the Humboldt Lovelock Irrigation Light & Power Company. [118]

I had no direct connections with the other ditch companies. Indirectly I did, in that the total quantity which these ditches were entitled to was ascertained and turned into the ditches for distribution by the ditch companies' representatives.

I know that the allocation of water was made by the State Engineer and later, by the decree, was to the individual property owners, and that is what we

(Testimony of Archie Miller.)

tried to follow. I determined from the order or decree how much water had been appropriated by the lánd owners served by a particular ditch and I allowed to go into the ditch the water to which the persons owning land along the ditch were entitled.

It would have been impossible to provide water to these lands pursuant to the decree or order without use of the ditches owned by these corporations.

A. JAHN,

a witness called on behalf of plaintiff, testified:

I am Secretary-Treasurer of Union Canal Ditch Company, and have been since 1926. That company for many years has carried water from the Humboldt River to lands in the Lovelock Valley, including the lands formerly owned by John G. Taylor. The company was incorporated in 1910. Its incorporators were owners of lands served by its canal. The canal was in existence prior to incorporation of the company. [119]

The decree establishing water rights (Exhibit 10) shows certain rights to the Union Canal as appurtenant to the described lands. The company does not own lands and makes no claim to the water as against the land owner.

John G. Taylor is shown as the holder of record of 150 shares of the company's stock, and has been since 1913.

The work of the company is keeping the ditch in

(Testimony of A. Jahn.)

repair and distributing water to the several owners after it is put in the ditch by the State Engineer. It derives its entire revenue by assessment, which is used to pay for the maintenance of the ditch. Land owners are entitled to the use of the ditch proportionately to the amount of stock held by them. Its ditch has been used to convey water from the Humboldt River to the Taylor lands, where it is placed to beneficial use.

8,000 shares of the company's stock were issued for cash, sold to the land owners along the ditch at par, and the money used to build the canal. The company never issued any stock for property.

The form of stock certificates used by the company is as follows:

"Location of Principal Office: Lovelock, Nevada.

Resident Agent: PETER ANKER
Incorporated Under the Laws of
State of Nevada.

No. Shares

Union Canal Ditch Company [120]

"Capital Stock $80,000.00 8000 Shares,
Par Value $10.00 Each

Fully Paid Up and Subject to Assessments

"This Certifies that..

is the owner of..............................Shares of the Capital Stock of

Union Canal Ditch Company

transferable only on the books of the Corpora-

(Testimony of A. Jahn.)

tion by the holder hereof in person or by Attorney upon surrender of this Certificate properly endorsed.

In Witness Whereof, the said Corporation has caused this Certificate to be signed by its duly authorized officers and to be sealed with the Seal of the Corporation this..............day of ...., A. D. 19..........

[Seal] ....

President Secretary

Shares $10.00 Each"

I have made a number of transfers of certificates to Federal Farm Land Bank, as pledgee. Under my practice I would not issue a new certificate except to a land owner along the ditch without authority of the board of directors, although there is no such limitation in the articles or by-laws of the corporation. The company derives no revenue from its operations, but the users of the ditch have paid about 50 cents an acre per year for the past twelve or fifteen years for the operation and maintenance thereof, and were entitled to the benefit of the use of the ditch to convey water to their lands. This is done by assessment. The amount has varied in different years. Aside from this source there are no other revenues. In a number of [121] cases certificates were transferred to the Federal Land Bank, as pledgee. Later, when they had foreclosed, new certificates to the Bank, as owner, were issued.

(Testimony of A. Jahn.)

The transfers to the Federal Land Bank, as pledgee, were made at the bank's request when they had a mortgage on the land. If they acquired title to the land, then the certificates would be transferred to them as owners. All of the stockholders of the company own lands supplied by water through the ditches of the company, with the exception of John G. Taylor. In his case water is carried through the company's ditch to the lands described in the decree which he then owned. The moneys received for maintenance of the ditch have averaged 50 cents per acre over a number of years. These assessments have been imposed in different amounts as deemed necessary by the directors. All the money received by the company was through such assessments at a certain rate per share. The number of shares owned was in proportion to the number of acres owned by these parties. The company has never been engaged in any business except the maintenance of its canal and the transmission of waters. Its only expenses have been in connection with such ditches, and no stock has been sold to persons not owning lands served by the ditch.

John G. Taylor acquired 150 shares in 1913, before I was a director. He was not a land owner at that time. That stock was originally connected with lands served by the Union Canal owned by a man named Lauritzen, who bought the land with the stock and transferred it to W. C. Noteware, to whom Certificate No. 63 for 150 shares was issued

(Testimony of A. Jahn.)

April 26, 1913. Noteware transferred to Taylor, to whom Certificate No. 65 was issued March 16, 1914.

There is nothing in the articles or by laws of the [122] company or in its stock certificates limiting the use of the ditch in proportion to the amount of stock held. There has never been any case where stock has gone delinquent for non-payment of assessment or the necessity of taking any steps by reason of such non-payment. Since the issuance of the 150 shares to John G. Taylor the canal has been used for the transmission of water to the lands owned by him at the time of issuance.

H. W. ROBERTSON,

a witness called on behalf of plaintiff, testified:

I am Secretary of the Old Channel Ditch Company, and have been for four years. This ditch is used to transmit water from the Humboldt River to lands bordering on the ditch, both natural flow and storage water. Water has been diverted through the ditch to the lands formerly owned by John G. Taylor, and applied to beneficial use thereon.

The stockholders of the company all own lands served by water transmitted through the ditch. This has been true throughout my acquaintance with the company. Its sole business is the maintenance and operation of the ditch, and it owns no property. The expenses of maintenance and operation are paid by assessment on the stockholders.

(Testimony of H. W. Robertson.)

I am also secretary of Humboldt Lovelock Irrigation Light & Power Company. It maintains a dam, impounding waters which are, when needed, discharged into the river and taken [123] out by the ditches to which reference has been made. Certain of such water is transmitted to the lands formerly owned by Taylor and put to beneficial use thereon. Taylor has been a stockholder of the company since its incorporation, holding about 37,000 shares, and the W. C. Pitt interests now hold about 28,000 shares. Certain transfers have been made, when Pitt sold portions of his ranch and with the land transferred shares of stock. After such transfer the water was put to beneficial use on the lands so transferred. Both of these interests hold Class A stock, and the remainder of that class of stock is also held by land owners served with water from the company's facilities. No water has been furnished to Class B stockholders since my connection with the company.

Certificates have been issued to the Federal Land Bank, as pledgee, also to the First National Bank of Reno, Richard Kirman and C. R. Lewis, the latter as pledgees of Mr. Pitt. These last named parties now own the Pitt ranch, having foreclosed on it. The mortgage was foreclosed about 1932, and the stock transferred to these people as owners. I know of only one case where stock was transferred to a party not a land owner, and that is 990 shares of Class B stock held by one E. E. Sullivan. There

(Testimony of H. W. Robertson.)
have been some sales of the stock between one farmer and another. The corporation itself has not sold stock other than to land owners.

I know of no class A stock held by a person not a [124] land owner.

Mr. Prince A. Hawkins owns 16,553 shares of Class B stock. He also owns lands in the Lovelock Valley. The Class B stock has not received water for approximately 10 years, as there was not enough available to serve that class.

The form of stock certificate issued by the company is as follows:

"Incorporated under the
laws of Nevada

"No.............................. .... Shares

Class Stock

Humboldt Lovelock Irrigation Light &
Power Co.

Capital Stock $145,953

Class A Stock, $120,953, Assessable

Class A Stock and Class B Stock, $145,953,
Assessable

"This Certifies that..is the owner of..............................shares, of one dollar each, full paid, but assessable, of the Class.......... Capital Stock of Humboldt Lovelock Irrigation Light & Power Company transferable only on the books of the Company at Lovelock, Nevada, in person or by duly authorized attorney, upon

(Testimony of H. W. Robertson.)

surrender of this Certificate properly endorsed.

"It is mutually agreed between the holder hereof and the Humboldt Lovelock Irrigation Light & Power Company and its stockholders as follows: That Class A stock is entitled to the preferential use of water from the Company to a maximum quantity of Ten Thousand acre feet each year, to be distributed pro rata [125] if requested, for the irrigation of lands, owned or irrigated by such stockholder, lying under or irrigated by means of water used through either the Irish-American or Last Chance, Old Channel, Young, or South West ditch or ditches situated in Lovelock Valley, Nevada, that such preferential use is expressly limited to such lands lying under said named ditches, and upon Class A stock being transferred to a transferee not a holder of Class A stock and not entitled to exercise such preferential use, Class B stock shall be issued to such transferee in lieu of the Class A stock so transferred; that, subject to such preferential right of Class A stock, Class A stock and Class B stock is entitled and has the same right to the use of water from the Company each year, to be distributed pro rata if requested, for the irrigation of lands owned or irrigated by such stockholder lying under or irrigated by means of water used through any ditch or ditch system in Lovelock Valley Nevada; that the price to be charged any stockholder of

(Testimony of H. W. Robertson.)

Class A stock or Class B stock for water furnished for irrigation purposes shall not exceed Seventy-five cents per acre foot per season and this limitation of a maximum charge shall not be increased by any amendment of the Articles of Incorporation, or in any way or manner whatsoever; provided, however, that the limitation of said maximum charge of Seventy-five cents per acre foot per season shall not apply to any water, in excess of the pro rata share, received by any stockholder from the Company.

"In Witness Whereof, the said Company has caused this [126] Certificate to be signed by its duly authorized officers and to be sealed with the seal of the Company at Lovelock, Nevada, this.........day of..............................., A. D. 19..........

....	....
Secretary	President"

DEFENDANT'S EXHIBIT B

is a copy of the minutes of the incorporators' meeting of Humboldt Lovelock Irrigation Light & Power Company held July 20, 1909. The original articles of incorporation of said company as therein set forth differ from the amended articles shown in Plaintiff's Exhibit No. 1 in the provisions of paragraph Fourth, which in the original articles provide as follows:

"Fourth. The total authorized capital stock of this corporation shall be five hundred thou-

(Testimony of H. W. Robertson.)

sand dollars ($500,000.00), divided into five hundred thousand shares (500,000), of the par value of one dollar ($1.00) per share, all of which shall be common stock. The amount of subscribed capital stock with which it will commence business is two thousand dollars ($2,000.00); The amount actually subscribed is two thousand dollars ($2,000.00), and the amount actually paid up is one thousand dollars ($1000.00).

"After the amount of the subscribed price of the capital stock has been paid in, or after it shall have been issued as fully paid up, it shall not be subject to assessments by the corporation except for the following purposes. All stock shall always be assessable and assessed by the corporation, after the amount of the subscribed price thereof [127] has been paid, and after it shall have been issued as fully paid up, as well as before, for the purpose of repairing and maintaining the property and business of the corporation and replacing its worn out or destroyed property.

"The capital stock of this corporation may be paid into the corporation either in cash, services, or by sale and transfer to the company of real or personal property, as in the judgment of the Board of Directors seems most advantageous to the company, and stock may be issued in exchange for such property, services,

(Testimony of H. W. Robertson.)

or cash and in such amounts as the Board of Directors may advise."

Said minutes also show that upon the offer of W. C. Pitt to transfer to the company water rights represented by Application No. 1098, dated August 21, 1908, and other properties, 15,000 shares of the company's stock were directed to be issued to W. C. Pitt.

Said minutes further show that W. C. Pitt, John G. Taylor and other parties having subscribed for or expressed a desire to subscribe for the capital stock of the corporation, it was resolved:

"Now Therefore, as an inducement for the immediate purchase of the capital stock of the Company, in addition to the dividends, which said persons shall receive as stockholders, which may from time to time be declared by the Directors, this Company is hereby authorized to enter into a contract with said persons whereby this Company shall always, during the irrigating seasons, furnish to each of said [128] persons, for irrigating purposes the use of such proportion of the waters of this Company that may be designated by the Board of Directors from time to time for irrigating purposes, as his amount of stock in this Company, for which he has now subscribed or shall subscribe for before August 19th, 1909, shall from time to time bear to the total amount of subscribed stock in

(Testimony of H. W. Robertson.)

this Company, at a price not to exceed seventy-five cents per year for each acre foot of water. Provided however that the use of all waters of this Company shall always be under and in accordance with the laws of Nevada, and all rules and regulations which the Board of Directors may from time to time establish. The President and Secretary of the Company are hereby authorized to execute such contracts on behalf of the Company."

DEFENDANT'S EXHIBIT "C"

is a copy of the by-laws of Humboldt Lovelock Irrigation Light & Power Company, which contain no restriction as to sale or transfer of the stock of said company. Said by-laws, however, provide in Article XIII as follows:

"Sec. 1. The proper irrigation of lands belonging to the stockholders of this Company shall always be this Company's primary object, and during the irrigating seasons no waters of this Company shall ever be used for any other purpose if such waters are necessary to properly irrigate the lands of the Company's stockholders."

It was thereupon stipulated between counsel for the respective parties that, pursuant to decree of foreclosure and sale in an action pending in the United States District Court, [129] in and for the District of Nevada, entitled "W. J. Tobin, as Re-

(Testimony of H. W. Robertson.)
ceiver of The Reno National Bank vs. John G. Taylor, et al.," No. H-114, the lands subject to the mortgage from John G. Taylor, Inc. to The Reno National Bank, set forth as Exhibit 2 herein, and the shares of stock described in the complaint herein were duly sold by the Special Master in Chancery appointed by the Court, and that all right, title and interest of The Reno National Bank, Reconstruction Finance Corporation, John G. Taylor, Inc. and John G. Taylor therein were duly sold and thereafter became and are vested in the substituted plaintiff, Pacific States Savings & Loan Company, without prejudice, however, to any rights of defendant herein; that said lands and said stocks were separately sold pursuant to said decree; that such separate sale was made without prejudice to the claims of plaintiff that the stocks pass as an appurtenance to the lands.

H. B. KRUSE,

a witness called on behalf of plaintiff, testified:

I am Secretary of Young Ditch Company, and have been such since its organization in 1915. The total number of shares of said company is 6,000, of which 2,880 stand in the name of John G. Taylor, who is the largest stockholder of the company and whose lands are the largest tract served by the Young Ditch Company.

(Testimony of H. B. Kruse.)

The company maintains and operates the Young Ditch and I do not know of any other business in which it [130] has been engaged. This has been true since its organization.

The water passed through the ditch is brought to the lands of the various owners and there placed to beneficial use. The stockholders are all land owners served by the ditch, and I know of no stockholders not owning lands served thereby. There have been some transfers of stock to the Federal Land Bank, as pledgee, in connection with mortgages on the lands, but I do not think there have been any transfers or sales of stock apart from such pledges.

The cost of maintaining the ditch is defrayed by assessment on the stockholders. I know of no other source of moneys wherewith to pay expenses. I do not think that the company itself claims any water rights outside of the right to the ditch.

The form of stock certificate used by the company is as follows:

"Incorporated Under the Laws of the State of Nevada, August 21, 1915

"No.......................... Shares..........................

Young Ditch Company

Capital Stock $60,000.00 6,000 Shares,

Par Value $10.00 Fully Paid and Assessable

Principal Office, Lovelock, Nevada

Resident Agent, John G. Taylor

"This Certifies that..is the owner of..................................Shares of the Capital

(Testimony of H. B. Kruse.)

Stock of Young Ditch Company transferable only on the books of the Corporation by the holder hereof in person or by Attorney upon [131] surrender of this Certificate properly endorsed.

"In Witness Whereof, the said Corporation has caused this Certificate to be signed by its duly authorized officers and to be sealed with the Seal of the Corporation this................day of ...., A. D. 19..........

[Seal]

....

Secretary President

Shares $10.00 Each"

Certificate No. 14 for 142.81 shares of Young Ditch Company stock was issued to Wanda Taylor on December 23, 1918, and assigned to John G. Taylor February 25, 1928. I do not know whether she was a land owner along the ditch during that time. I think I know all the other stockholders. When I issue certificates I do not require the stockholders to satisfy me that they are land owners because I know them all. I know of nothing in the articles or by-laws of the company or the stock certificate which requires that stockholders shall be land owners.

At the organization meeting of the company the following resolution was adopted:

"On motion duly made, seconded and unanimously carried, it was resolved that the Presi-

(Testimony of H. B. Kruse.)

dent and Secretary of the company be authorized and directed to have the proper and necessary deed of conveyance to this company of all the interest of the subscribers of the capital stock of this company, transferring all their right, title and interest [132] of, in and to all water, water rights, dams, ditches, canals, flumes and easements now held and owned by them in what is known as and called the Young Ditch, a co-partnership, the tenants in common of said interest in said Young Ditch being as follows: (names of parties here stated in resolution);

"And be it further resolved that upon the execution by said above-named parties of such deed of conveyance to said Young Ditch Company, that the President and Secretary of this company are hereby authorized and directed to issue said parties, as payment in full for their said interest in said Young Ditch, certificates of stock in this corporation, fully paid up, in amount as their respective interest so conveyed bears to the number of shares 6,000, representing the capital stock of this company."

Such conveyances were made and stock issued in accordance with that resolution, as appears from the minutes of the meeting of the board of directors held on November 1, 1915, as follows:

"* * * that proper deed of conveyance between the subscribers to the capital stock of

(Testimony of H. B. Kruse.)

> this company, conveying all their interest in the Young Ditch to this company had been drawn and had been signed and executed by all said parties, with the exception of S. R. Young, who refused to join in the incorporation and desired to hold his interest [133] separate and distinct from that of the corporation."

At that time I owned a two-share interest in the ditch and owned lands served thereby. I still own the land but think that I executed some conveyance to Young Ditch Company. I do not know whether such conveyance included any water rights.

The stock book shows that certificates were issued for 253.31 shares to Nevada Fire Insurance Company, as pledgee of Mrs. Paula Jacobson, for 393.2 shares to Federal Land Bank of Berkeley, as pledgee of H. M. Damm, and for 642.80 shares to said bank as pledgee of John Holmstrom.

A copy of the by-laws of Young Ditch Company was introduced in evidence by defendant as Exhibit "F". The same contained no provisions restricting stock ownership to land owners served by the ditch.

P. L. NELSON,

a witness called on behalf of defendant, testified:

On May 12, 1932, I was Cashier of The Reno National Bank and of Bank of Nevada Savings &

(Testimony of P. L. Nelson.)

Trust Company. I have been such cashier since 1931, and prior thereto for about fourteen years Assistant Cashier of those banks. After the banks were closed I was employed by the Receivers of the Bank of Nevada Savings & Trust Company in connection with winding up its affairs. [134]

Three notes payable to Bank of Nevada Savings & Trust Company, signed by John G. Taylor, Inc., by John G. Taylor, President, and A. R. Randolph, Secretary, each dated at Reno, Nevada, payable on demand, with interest at 7% per annum, one dated May 12, 1932, in the principal amount of $7500, another dated May 28, 1932, in the principal amount of $10,000, and the other dated June 4, 1932, in the principal amount of $15,000, were, while I was employed by the Receiver of the Bank of Nevada Savings & Trust Company, in the possession of the Receiver and among the files and records of that bank. Each of said notes bears a lead pencil notation in the upper left-hand corner of the initials "J.S." These are the initials of Jerry Sheehan. According to the then practice and custom of Bank of Nevada Savings & Trust Company and The Reno National Bank, it was the custom for the officer making the loan to initial it for future reference as the party who handled the transaction or would be responsible for the loan.

The first note for $7500 has an endorsement showing payment of $675 on principal made June 30, 1936, from the sale of 5 shares of First National

(Testimony of P. L. Nelson.)

Bank of Lovelock stock to C. H. Jones. That note also has an endorsement showing payment of $70. interest to June 30, 1932.

The second note for $10,000 has an endorsement showing payment of $62.22 interest to June 30, 1932.

The $7500 note also has a lead pencil notation on the bottom "shearing" in Mr. Sheehan's handwriting. According to the [135] banking practice and customs, that notation indicates that the advance was made for shearing expenses of the maker. I cannot say definitely whether the money advanced was so used.

The $15,000 note dated June 4, 1932, has a lead pencil notation "taxes and wages," which indicates that the advance was for the purpose of paying such items.

DEFENDANT'S EXHIBIT "H"

is in words and figures as follows:

"Reno, Nevada, April 29, 1932

"As collateral security for the payment of all of my present indebtedness to Bank of Nevada Savings & Trust Company, of Reno, Nevada, and all of my future indebtedness to said Bank, which I may incur hereafter from any cause or upon any consideration I have assigned, and do hereby assign, deliver and deposit with said Bank the following described property, to-wit:

(Testimony of P. L. Nelson.)

55 shs. Reno National Bank, Reno, Nev. Ctf. No. 1030.

225 shs. First Natl. Bank, Winnemucca, Cap. stock, Ctf. No. 253

5 shs. First Natl. Bank, Lovelock, Nev. Cap. stock Ctf. No. 49

50 shs. Reno Natl. Bank, Reno, Nev., Cap. stock, Ctf. No. 673

15 shs. Churchill County Bank, Fallon, Nev., Ctf. No. 74

150 shs. Union Canal Ditch Co., Cap. stock, Ctf. No. 65.

37,273 shs. Humboldt. Lovelock Irr. Lt. & Pr. Class "A" Ctfs. Nos. 2, 23, 59, 71, 74, 96, 99, 108 and 111

2,857 shs. Young Ditch Co., capital stock, Ctfs. Nos. 16 and 24.

1,121 1/3 shs. The Old Channel Ditch Co. Cap. Stock, Ctfs. Nos. 27, 35, 59, 62, 70, 103.

..........................of the..........................value of ....Dollars, [136] and hereby given authority to said Bank, or its assigns, to call for such additional security as it, or its assigns, may deem proper, which security I agree to give on demand, and on default being made in giving such security or in paying said indebtedness, then all of my indebtedness to said Bank shall be considered due and immediately payable, whether otherwise due or

(Testimony of P. L. Nelson.)

payable or not, at the option of said Bank, or its assigns, and the said Bank is hereby given authority to sell and deliver the whole or any part of said property, at either public or private sale, at any time or place, either with or without demand for payment, either with or without notice of such sale, and either with or without advertisement of such sale, as said Bank, its officers or agents may elect; such demand, notice and advertisement are hereby waived. At such sale said Bank or any other person or persons may become the purchaser of the whole or any part of said property. After deducting all costs and expenses incurred in connection with such sale, including reasonable attorney's fee, and the amount of said indebtedness, out of the proceeds of such sale, the surplus, if any, shall be paid to me or my heirs, or assigns, and I agree to pay any deficiency there may be, if any, in the payment of said indebtedness and costs and expenses of such sale, after the proceeds of sale have been applied as aforesaid. The Bank or its assigns, may permit the substitution of security, and all substituted security, and/or additional security, shall be subject to the terms hereof as if originally deposited.

JOHN G. TAYLOR." [137]

All of the certificates described in Exhibit "H" were in the possession of the bank at the time of the receivership and have been and still are in the Re-

(Testimony of P. L. Nelson.)

ceiver's possession, except that for 5 shares of First National Bank of Lovelock stock, which was sold.

Defendant introduced in evidence certificates representing the stock described in the complaint herein, all of which are in the form of the respective stock certificates of the companies mentioned as hereinbefore set forth, as follows:

Certificate No.	Shares	Date
	Humboldt Lovelock Irrigation Light & Power Company Class A	
2	7200	January 2, 1917
23	8120	January 2, 1917
59	100	January 2, 1917
71	1000	June 29, 1917
74	20000	June 17, 1918
96	450	November 10, 1924
99	270	May 18, 1925
108	49	September 12, 1927
111	84	November 12, 1927
	Stock of Union Canal Ditch Company	
65	150	March 16, 1914
	Stock of Young Ditch Company	
16	2714.20	January 23, 1918
24	142.80	February 27, 1928
27	20	January 31, 1902

[138]

Certificate No.	Shares	Date
	Old Channel Ditch Company	
35	80	May 7, 1904
59	93⅓	May 9, 1910
62	80	June 1, 1912
70	120	December 21, 1915
103	182	November 1, 1928

(Testimony of P. L. Nelson.)

Each of said certificates was issued in the name of John G. Taylor, and each thereof is endorsed in blank by John G. Taylor in the presence of and witnessed by J. Sheehan. All of said certificates were produced from the files and records of the Bank of Nevada Savings & Trust Company receivership. The records of the Bank of Nevada Savings & Trust Company show that there was paid to John G. Taylor, Inc. the principal amount of the notes above described, $32,500. The same note teller handled the loan transactions for The Reno National Bank and the Bank of Nevada Savings & Trust Company. The teller at the time these transactions were handled was Miss Jean Campbell. Payments made for the account of the Bank of Nevada Savings & Trust Company and receipts for its account were totaled each day and the difference credited or charged to the account of the Bank of Nevada Savings & Trust Company on the books of The Reno National Bank, with corresponding entries on the books of the former. The $32,500 credited to John G. Taylor, Inc. was made through a credit from The Reno National Bank to the First National Bank of Winnemucca. Taylor had an account at the Winnemucca Bank but not at either of [139] the Reno banks. The obligation evidenced by the notes mentioned was solely to the Bank of Nevada Savings & Trust Company. With the exception of the payment on account of principal and interest previously described, the balance of prin-

(Testimony of P. L. Nelson.)

cipal and accrued interest is still due to the Receivership of the Bank of Nevada Savings & Trust Company.

Mr. Seaborn, State Superintendent of Banks, took over the Bank of Nevada Savings & Trust Company December 9, 1932. I was employed by him thereafter, in charge of its assets and supervision of necessary work. At that time the notes and stocks previously described were in the files and records of that bank and remained there throughout the receivership of Mr. Seaborn and that of his successor, Leo F. Schmitt, and have so remained up to the present date.

The stock of the Bank of Nevada Savings & Trust Company and that of The Reno National Bank was held in corresponding interests by the same stockholders. The banks occupied the same premises and had the same officers. The amounts represented by the notes previously described were advanced as follows: $7500, represented by the note of May 12, 1932, was advanced on May 13, 1932; $10,000, represented by the note of May 28, 1932, was advanced on June 1, 1932, and $15,000, represented by the note of June 4, 1932, was advanced June 6, 1932. I do not recall seeing Exhibit "H" prior to the time Mr. Seaborn, as Superintendent of Banks, took charge of the Bank of Nevada Savings & Trust Company, [140] on December 9, 1932. I had nothing to do with its actual receipt. It is in the customary bank form used for many years. I

(Testimony of P. L. Nelson.)

do not know what happened to this particular document.

It was part of my duties as cashier to keep informed as to collateral deposited to secure loans. I have no recollection of having heard anything about the advances made to John G. Taylor, Inc. It was not always customary to make any notation of the collateral on the notes representing particular loans. Sometimes it was done. It was not customary to note loans in respect of which collateral was held on the collateral envelope itself.

JERRY SHEEHAN,

a witness called on behalf of defendant, testified:

From 1924 until the bank closed I was Vice-President of Bank of Nevada Savings & Trust Company, and during the same period I occupied the same position with The Reno National Bank. I was also a director of both banks. The personnel and directorate of both banks was the same, the same persons acting in an equivalent capacity for both throughout the period I was there. Both banks conducted their business in the same banking room.

The initials "J. S." on the notes of John G. Taylor, Inc. to Bank of Nevada Savings & Trust Company, above described, are my initials. They represent my approval and authorization of the loan. The notation "taxes and wages" on the $15,000 note dated June 4, 1932, is in my handwriting. The

(Testimony of Jerry Sheehan.)

notation [141] was placed thereon to indicate the purpose of the loan. I think I received the information from the cashier of the First National Bank of Winnemucca. The loan was made because it was understood to be necessary to furnish Mr. Taylor with some expense money. The notation on the $7500 note "shearing," is in my handwriting, and signifies that the request for money was for that purpose.

I have no recollection of having seen the collateral agreement dated April 29, 1932, defendant's Exhibit "H". I do not know how it was obtained. I am familiar with Mr. Taylor's signature, and the signature thereon is his. I do not know of my own knowledge whether collateral was exacted from John G. Taylor, Inc. as security for the notes above referred to. I was familiar with the Nevada law that no loans could be made by a savings bank in Nevada without collateral. Until this morning I never saw the stock referred to in the collateral agreement. The transaction was handled through Winnemucca to the best of my recollection.

I made the request of Mr. Taylor for the collateral by way of stock in various corporations. At the time we attempted to consolidate the Taylor loans in the early part of 1932, there was discussion of security with Mr. Taylor, and he furnished a list of all his property, both that of John G. Taylor, Inc. and of himself personally. I do not recall that the water stocks were specifically mentioned. He

(Testimony of Jerry Sheehan.)

agreed to furnish as collateral everything that he had. He complied with our request that he furnish as collateral all the stock in the various corporations. I know Mr. Taylor borrowed $32,500.00 from the Bank of Nevada Savings & Trust Company and gave his notes shown in the evidence and put up collateral as shown by the collateral agreement.

There was considerable discussion in the early part of 1932 about the consolidation of the Taylor loans, which were previously unsecured. Several discussions were had, [142] both with Mr. Taylor and with the officials of the Reconstruction Finance Corporation. It was repeatedly stated that all of the property of John G. Taylor, Inc. and John G. Taylor was to be put up as security. Following these conversations the loans were consolidated into a single loan of $700,000, represented by note from John G. Taylor, Inc. to The Reno National Bank, secured by chattel mortgage and real estate mortgage. At the time the real estate mortgage was being prepared, Mr. Taylor was told that he was expected to give all the security which his company had, and he agreed to do so. This note and the mortgages were later assigned to the Reconstruction Finance Corporation, which advanced to The Reno National Bank more than One Million Dollars. In the discussions with the officials of the Reconstruction Finance Corporation the properties of John G. Taylor and John G. Taylor, Inc. were discussed at considerable length. I answered all

(Testimony of Jerry Sheehan.)

questions respecting the same to the best of my ability. I probably stated that the Lovelock properties were irrigated, and probably told them about the Pitt-Taylor dam. I knew that about 2,000 acres of the land in question were irrigated and that the Pitt-Taylor dam was used for such irrigation. I probably told these officials of the value attaching to the lands by reason of such irrigation.

The transaction with the Reconstruction Finance Corporation was with The Reno National Bank, and the Taylor loan was made by that bank. The Bank of Nevada Savings & Trust Company had nothing to do with it. At the time of the negotiations we had no collateral. The mortgage was taken [143] for the purpose of that transaction. The mortgage was submitted to the representatives of the Reconstruction Finance Corporation for their consideration, and, after discussion, assigned to them. I know of nothing other than the real estate and chattel mortgages so assigned.

I supposed all the vested water rights belonged to John G. Taylor, Inc., but did not know that they were represented by stock. I knew about the reservoir stock but not about the ditch companies. I thought they were vested rights attached to the ranches. If I had known that John G. Taylor, Inc. owned stock in the water companies I think I would have asked for a transfer thereof. I do not remember when, if at all, I first saw the water stock certificates here in question. I must have ex-

(Testimony of Jerry Sheehan.)

amined the collateral at the time of going through the bank, but I do not recall it. It was our custom to list the collateral behind each loan and furnish the officers a copy of such report which should be on file in each bank. I think this custom was observed respecting these loans and collateral.

LEO F. SCHMITT,

a witness called on behalf of defendant, testified:

I am Receiver of the Bank of Nevada Savings & Trust Company, and have served in that capacity since February 28, 1934. I have possession of all the assets and properties of that bank and received the same from E. J. Seaborn, [144] the State Superintendent of Banks. Among the assets so received were the collateral agreement and stock certificates of the water companies, hereinbefore referred to. These have been in my possession continuously since my appointment.

In December, 1934, I paid an assessment of $6522.77 on the stock of the Humboldt Lovelock Irrigation Light & Power Company, and in November, 1936, an additional assessment of $3354.57. In March, 1936, an assessment of $112.15 was paid on the stock of Old Channel Ditch Company. No other assessments have been paid by me.

At the time of paying the assessments referred to I knew there was a dispute respecting owner-

(Testimony of Leo F. Schmitt.)

ship of the stock, and before making payments it was agreed with Reconstruction Finance Corporation that in the event it was adjudicated to be the owner of the stock, the payments would be adjusted in accordance with the rights of the parties. [145]

STIPULATION.

It is hereby stipulated that the foregoing statement of evidence is a true, complete and properly prepared statement of the substance of all of the testimony and evidence introduced on the trial of the above-entitled cause, and that the same may be settled and allowed forthwith.

(Signed) BROBECK, PHLEGER & HARRISON
ORRICK, DAHLQUIST, NEFF & HERRINGTON
Attorneys for Plaintiff and Appellant.
PLATT & SINAI
Attorneys for Defendant and Appellee. [146]

ORDER SETTLING STATEMENT OF EVIDENCE.

The foregoing statement of evidence is a true, complete and properly prepared statement of the substance of all of the testimony and evidence in-

troduced and admitted on the trial of the above-entitled cause in the United States District Court for the District of Nevada, all parts not essential to the questions presented by the appeal being omitted, and the same is hereby settled, allowed and approved as the Statement of Evidence on Appeal from the final decree of said court.

Dated: October 4th, 1938.

FRANK H. NORCROSS
District Judge.

[Endorsed]: Filed Oct. 4, 1938. [147]

[Title of District Court and Cause.]

STIPULATION AS TO RECORD.

It Is Hereby Stipulated by and between the parties to the above-entitled matter that the parts of the record, proceedings and evidence to be included in the record on appeal herein be and the same are hereby designated as follows:

(1) Bill of Complaint;

(2) Demurrer;

(3) Minute Order Overruling Demurrer; [148]

(4) Answer;

(5) Supplemental Complaint;

(6) Opinion of the Court;

(7) Findings of Fact and Conclusions of Law;

(8) Final Decree;

(9) Petition for Rehearing (omitting the argument in support thereof therein contained);

(10) Memorandum Decision on Petition for Rehearing;

(11) Petition for Appeal;

(12) Assignment of Errors;

(13) Order Allowing Appeal;

(14) Undertaking on Appeal;

(15) Statement of the Evidence;

(16) Order Enlarging Time to Prepare Transcript of Record and to Docket Appeal;

(17) This stipulation.

The Clerk is hereby requested to prepare for transmission to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, at San Francisco, California, certified copies of the aforementioned papers as and for the record on appeal and to transmit the same, together with the original citation, to the Clerk of said United States Circuit Court of Appeals for the Ninth Circuit.

BROBECK, PHLEGER & HARRISON
ORRICK, DAHLQUIST, NEFF & HERRINGTON
Attorneys for Plaintiff and Appellant.

PLATT & SINAI
Attorneys for Defendant and Appellee.

[Endorsed]: Filed Oct. 4, 1938. [149]

[Title of District Court and Cause.]

CERTIFICATE OF CLERK U. S. DISTRICT COURT TO TRANSCRIPT OF RECORD.

United States of America,
District of Nevada—ss.

I, O. E. Benham, Clerk of the District Court of the United States for the District of Nevada, do hereby certify that I am custodian of the records, papers and files of the said United States District Court for the District of Nevada, including the records, papers and files in the case of Pacific States Savings & Loan Company, a corporation, substituted for Reconstruction Finance Corporation, a corporation, Plaintiff, vs. Leo F. Schmitt, as Receiver of Bank of Nevada Savings & Trust Company, Carson Valley Bank, Tonopah Banking Corporation and Virginia City Bank, Defendant, said case being No. H-117 on the equity docket of said court.

I further certify that the attached transcript, consisting of 154 typewritten pages numbered from 1 to 154, inclusive, contains a full, true and correct transcript of the proceedings in said case and of all papers filed therein, together with the endorsements of filing thereon, as set forth in "Stipulation as to Record" filed in said case and made a part of the transcript attached hereto, as the [150] same appears from the originals of record and on file in my office as such Clerk in Carson City, State and District aforesaid.

I further certify that the cost for preparing and certifying to said record, amounting to $58.25, has been paid to me by Messrs. Brobeck, Phlegar & Harrison, of counsel for appellant in the above entitled cause.

And I further certify that the original citation, issued in said cause, is hereto attached.

Witness my hand and the seal of said United States District Court this 17th day of October, A. D. 1938.

[Seal] O. E. BENHAM

Clerk, U. S. District Court,
District of Nevada. [151]

[Title of District Court and Cause.]

CITATION ON APPEAL.

The United States of America—ss.

The President of the United States of America:

To Leo F. Schmitt, as Receiver of Bank of Nevada Savings & Trust Company, Carson Valley Bank, Tonopah Banking Corporation and Virginia City Bank, and to Platt & Sinai, his attorneys, Greetings:

You are hereby cited and admonished to be and appear in the United States Circuit Court of Appeals for the Ninth [152] Circuit to be holden at the City and County of San Francisco, State of California, within thirty (30) days from the date hereof pursuant to an order filed and of record in

the office of the Clerk of the United States District Court for the District of Nevada, allowing an appeal from a decree made and entered on April 6, 1938, which became final on June 27, 1938, upon the denial of a petition for rehearing seasonably made and filed and duly entertained by the Court, in the above-entitled cause wherein Pacific States Savings & Loan Company, a corporation, substituted for Reconstruction Finance Corporation, is appellant, and you are appellee, to show cause, if any there be, why the said decree should not be reversed and corrected, and why speedy justice should not be done the parties in that behalf.

Witness The Honorable Frank H. Norcross, Judge of the United States District Court for the District of Nevada, this 22nd day of August, 1938.

FRANK H. NORCROSS

Judge of the United States District Court for the District of Nevada. [153]

Due service and receipt of a copy of the within Citation on Appeal is hereby admitted, this 22nd day of August, 1938.

PLATT & SINAI

Attorneys for Appellee.

[Endorsed]: Filed Aug. 22, 1938. [154]

[Endorsed]: No. 9015. United States Circuit Court of Appeals for the Ninth Circuit. Pacific States Savings & Loan Corporation, a corporation, substituted for Reconstruction Finance Corporation, a corporation, Appellant, vs. Leo F. Schmitt, as Receiver of Bank of Nevada Savings & Trust Company, Carson Valley Bank, Tonopah Banking Corporation and Virginia City Bank, Appellees. Transcript of Record. Upon Appeal from the District Court of the United States for the District of Nevada.

Filed October 18, 1938.

PAUL P. O'BRIEN,

Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

No. 9015

United States Circuit Court of Appeals

For the Ninth Circuit

PACIFIC STATES SAVINGS & LOAN COMPANY, a corporation, substituted for Reconstruction Finance Corporation, a corporation,
Appellant,

vs.

LEO F. SCHMITT, as Receiver of BANK OF NEVADA SAVINGS & TRUST COMPANY, CARSON VALLEY BANK, TONOPAH BANKING CORPORATION and VIRGINIA CITY BANK,
Appellees.

BRIEF FOR APPELLANT

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No. 9015

United States Circuit Court of Appeals

For the Ninth Circuit

ACIFIC STATES SAVINGS & LOAN COMPANY, a corporation, substituted for Reconstruction Finance Corporation, a corporation,
Appellant,

vs.

LEO F. SCHMITT, as Receiver of BANK OF NEVADA SAVINGS & TRUST COMPANY, CARSON VALLEY BANK, TONOPAH BANKING CORPORATION and VIRGINIA CITY BANK,
Appellees.

BRIEF FOR APPELLANT

STATEMENT OF PLEADINGS AND FACTS SHOWING JURISDICTION.

The District Court had jurisdiction under Title 28, U. S. C., Sec. 400, and under Title 28 U. S. C., Sec. 41(1), the matter in controversy exceeding the sum of $3,000 and the action arising under the laws of the United States. The action was instituted in the United States District

References (R. ....) are to pages of the Transcript of Record.
All emphasis herein is supplied by us.

Court for the District of Nevada by Reconstructio
Finance Corporation, a corporation organized under th
laws of the United States (15 U. S. C., Sec. 601), all o
the stock of which is owned by the United States (1
U. S. C., Sec. 602). It was brought to obtain a declaratio
that the plaintiff is entitled to a lien upon stock of certai
reservoir and canal companies alleged to be appurtenan
to lands in the State of Nevada subject to a mortgag
which had been assigned to plaintiff (Complaint, R. 2)
During the pendency of the action the mortgage was fore
closed, the property subject thereto was sold, and Pacifi
States Savings and Loan Company, a California corpora
tion, which had succeeded to the interest of plaintiff i
the property in controversy was substituted as plaintif
(Supp. Bill of Complaint, R. 32, Order R. 78, and Stipu
lation R. 132).

Issue was joined (Answer, R. 17, and Stipulation
R. 78 and 132) upon the original bill and supplementa
bill.

From the final judgment (R. 61 and 66) this appea
has been prosecuted by the substituted plaintiff. This
court has jurisdiction of the appeal under Title 28, U. S. C.
Sec. 225(a).

STATEMENT OF THE CASE.

A. THE ACTION.

This action was commenced by Reconstruction Finance
Corporation (hereinafter referred to as R. F. C.) to ob-
tain a declaration that the stock of certain reservoir and

tch companies described in the complaint is subject to
ie lien of a mortgage executed by the then owner of
ertain lands in the Lovelock Valley, also described in the
omplaint, made to The Reno National Bank and by it
ssigned to the R. F. C. The facilities of the reservoir
nd ditch companies had for many years been used to
rigate the mortgaged lands, and it was claimed that the
tocks of these companies were an appurtenance to the
and and as such subject to the mortgage. It was also
laimed that whether or not an appurtenance, the stocks
ad been in fact mortgaged. During the pendency of the
ction the mortgage was foreclosed and appellant Pacific
States Savings & Loan Company, which had acquired title
o the mortgaged property, was substituted as plaintiff
nd by supplemental complaint asserted its rights to the
tocks in question as the owner thereof.

Defendant, who is receiver of four Nevada state banks,
y his answer asserted an attachment lien on behalf of
hree of the banks for which he is receiver, but no evi-
lence was introduced in respect of such alleged attach-
nent liens. On behalf of Bank of Nevada Savings & Trust
Company, of which he is also receiver, defendant asserted
a lien under a pledge agreement executed subsequent to
the mortgage of the land by one John G. Taylor, in whose
name the stock in question stood of record.

The District Court found that the companies whose
stock is here in controversy have at all times been en-
gaged solely in the maintenance and operation of certain
reservoirs and ditches for the diversion of waters in the
Humboldt River and their transmission to lands in the
Lovelock Valley and that plaintiff, as owner of the lands

in question, became and is entitled to all water rights and the use of the necessary facilities for irrigation as an appurtenance to the lands conveyed. The court, however found that plaintiff was not entitled to the stock in question otherwise than as it might be affected by the water rights found to be owned by plaintiff (Opinion, R. 35). The substituted plaintiff has appealed from the decree in respect of this latter determination.

B. THE APPELLANT'S GROUNDS FOR REVERSAL.

Appellant will rely on the following propositions as grounds for reversal:

1. The stock in controversy is appurtenant to the land and passed by conveyance thereof.

This question is raised by the allegations of the bill of complaint and by the findings of fact of the court below. The conclusions of law and the decree of the court below are claimed to be unsupported by the findings of fact and contrary to the legal effect of the facts found.

2. The defendant and the bank of which he is receiver are not bona fide purchasers for value.

This issue was raised by the bill of complaint. The court below made no findings thereon.

C. STATEMENT OF THE FACTS.

Prior to June 9, 1930, John G. Taylor owned, with other property, certain lands in the Lovelock Valley, Humboldt County, Nevada, specifically described in the complaint. Without water these lands are practically valueless, but with water for irrigation they are productive and of sub-

antial value. While the lands have certain rights to the se of the waters of the Humboldt River based on appro-riation and diversion for beneficial use, these rights are f such late priority that only in times of exceptional ater conditions are they sufficient fully to irrigate the inds in question (Finding XIX, R. 55). Under an appro-riation made by Humboldt Lovelock Irrigation Light & ower Company that company is authorized to maintain dam known as the Pitt-Taylor Reservoir and impound ertain waters of the Humboldt River during flood seasons o supplement the vested water rights of certain lands escribed in the permit, including the lands then owned y Taylor and now owned by plaintiff (Finding XX, R. 56, Exhibits 11 and 12, R. 107). In the transmission f the waters so impounded in the Pitt-Taylor Reservoir, s well as under the direct appropriation, the ditches wned by Young Ditch Company, Old Channel Ditch Com-any and Union Canal Ditch Company are used. Such vas the situation for many years prior to June 9, 1930, nd such continued to be the situation thereafter.

On June 9, 1930, John G. Taylor conveyed to John G. Taylor, Inc., a Wyoming corporation, all of the lands in question, "together with the appurtenances * * * also all water rights, ditches and canals appurtenant to said and or used in connection therewith, and all shares of stock of any water corporation appurtenant to said land or the water from which are used or have been used in connection with the irrigation or cultivation thereof" (R. 79, Finding X, R. 49). The stock of the four water companies continued to stand in the name of John G. Taylor, and still stands in his name (R. 142, 143). The

water, however, continued to be used for the Taylor lands as it had been prior to the conveyance to John G. Taylor, Inc. and is still so used (Finding XVI, R. 54).

On April 20, 1932 (R. 80), John G. Taylor, Inc. mortgaged to The Reno National Bank, as security for an indebtedness of $700,000 evidenced by a promissory note dated March 12, 1932, all of the lands in question

> "Together with all water, water rights, water applications and water permits, or privileges, connected with, belonging, appurtenant or incident to the lands hereby conveyed, or used in connection with all or any part of the said premises, or used or usable in connection therewith, and all dams, reservoirs and ditches, canals or other works for storage or carrying of water now owned by the mortgagor, or in which it now has, or may hereafter acquire any interest, and all applications now pending in the office of the State Engineer of the State of Nevada, for any and all waters to be used upon any part or portion of the said lands, or used in connection therewith.
>
> "Together with all and singular the tenements, hereditaments and appurtenances thereunto belonging, and in anywise appertaining, and the reversion and reversions, remainder and remainders, rents, issues and profits thereof."

This mortgage was dated as of March 12, 1932, the date of the note, and replaced, to correct an error in description, a mortgage executed on March 12, 1932 (Complaint, R. 7 and Answer, R. 19). It was executed without the formalities, required by law respecting the mortgage of chattels (R. 81). A chattel mortgage dated March 12,

932 was also executed but did not describe the stock in question (R. 81). This note and the mortgages securing the same were assigned by The Reno National Bank to Reconstruction Finance Corporation to secure in part a loan exceeding One Million Dollars made by the R. F. C. to The Reno National Bank (R. 81). Default having occurred, the mortgage was foreclosed, the property sold, and the property subsequently conveyed to Pacific States Savings & Loan Company (R. 132).

At the time the mortgage from John G. Taylor, Inc. to The Reno National Bank was being arranged as a consolidation of various loans then held by the bank, representatives of the R. F. C. were in consultation with the representatives of The Reno National Bank, it being then contemplated that the mortgage was to be assigned to the R. F. C. (R. 104-106, 147-148). The lands in question were represented as possessing water rights and as being the most valuable of the Taylor lands by reason of their agricultural possibilities through the possession of such water rights (R. 104-105). It was not known by the R. F. C. that the water rights were in any way represented by the stock of corporations (Finding XIV, R. 52). Mr. Sheehan, then executive vice-president of The Reno National Bank, through whom the transaction was arranged, testified that it was understood the mortgage was to cover all property of every kind owned by the Taylor Company, and that company agreed that it should; also that the water rights and all incidents thereto were included (R. 147-148).

The Bank of Nevada Savings & Trust Company, a state bank, was owned by the same interests as owned the

stock of The Reno National Bank. It occupied the same banking rooms and had the same officers and directors and personnel (R. 144). Subsequent to the execution of the mortgage from John G. Taylor, Inc. to The Reno National Bank and its assignment to the R. F. C., a pledge agreement was signed by John G. Taylor personally, dated April 29, 1932, pledging to the Bank of Nevada Savings & Trust Company as security for then or future indebtedness certain described stocks, including with others, the stocks here in question. At that time Taylor was not indebted to the Bank of Nevada Savings & Trust Company, but subsequently various sums were borrowed from that bank by John G. Taylor, Inc., the notes being endorsed by John G. Taylor (Finding XV, R. 53). The same Mr. Sheehan acted for the Bank of Nevada Savings & Trust Company in authorizing these loans. He testified that he did not then know of the pledge agreement, did not see the certificates representing the water stocks, and in fact did not recall having seen them until the day of the trial (R. 146). Mr. Sheehan is the same person who had handled the $700,000 note and mortgage transaction and who testified that he demanded that there be hypothecated to secure that note all the property which Taylor owned individually as well as all property which his corporation, John G. Taylor, Inc., owned (R. 145-146).

The notes payable to the Bank of Nevada Savings & Trust Company not having been paid, defendant, as receiver of that bank, claims a lien upon the stocks. While the pleadings indicate a claim of defendant, as receiver of three other Nevada state banks, by virtue of attachments, there is no evidence in the record disclosing the nature or extent of such lien.

The articles of incorporation and stock certificates of the four water companies whose stocks are here involved appear in the record (R. 82, 89, 93, 94, 122, 127 and 134). With the exception of the Humboldt Lovelock Irrigation Light & Power Company, there is nothing in the articles, by-laws or stock certificates of these companies indicating any particular restrictions on the disposition of the stock or priority to their stockholders in the use of their respective facilities. However, the court found and evidence shows that the only assets of these companies are the ditches constructed by use of the proceeds of the sale of their stock to landowners served by the ditches; that their only business is the maintenance of these ditches in the transmission of water to the lands of the stockholders; that their only revenue is obtained from assessment upon the stockholders to meet the operating expenses; that in practice the use of their facilities has always been confined to stockholders, and that their stocks have been transferred only as an incident to a transfer of lands. In some cases transfers in pledge have been made in connection with mortgages of the lands of the stockholders, principally to the Federal Farm Loan Bank (Finding XVII, R. 54 and R. 123-137).

The stock of the Humboldt Lovelock Irrigation Light & Power Company is of two classes—Class A and Class B. Only Class A stock is here involved. The articles of incorporation of that company provide that:

> "* * * the stockholders of our said corporation shall always be entitled, by virtue of being such stockholders, to a preferential use, over all other persons, natural or artificial, of all water owned or

> possessed by our said corporation for the irrigation of lands owned or possessed by such stockholders; * * *." (R. 82)

It is further provided:

> "* * * Class A stock shall have certain preferential rights over Class B stock, to wit: Class A stock shall be entitled to the preferential use of water from the Company of a maximum quantity of 10,000 acre feet each year, to be distributed pro rata if requested, for the irrigation of lands owned or irrigated by such stockholder, lying under or irrigated by means of water used through either the Irish American or Last Chance, Old Channel, Young or South West Ditch or ditches, situated in Lovelock Valley, Nevada; that such preferential use shall be expressly limited to such lands lying under said named ditches, and upon Class A stock being transferred to a transferee not a holder of Class A stock and not entitled to exercise such preferential use, Class B stock shall be issued to such transferee in lieu of the Class A stock so transferred; * * *" (R. 85)

This preferential right is repeated in the form of stock certificate (R. 128).

As in the case of the other companies, the only asset of Humboldt Lovelock Irrigation Light & Power Company is the so-called Pitt-Taylor reservoir. Its only activity has been in the maintenance of that reservoir and distribution of water to its stockholders. Its stock also was issued only to landowners served thereby. Its only revenue is the charge made against its stockholders and assessments on the stockholders to meet the operating expenses of its facilities (Finding XX, R. 56). Although

ts articles of incorporation would permit engagement n other lines of business "it has never engaged in any business or activity other than the business or activity of acting as the agent of its stockholders in diverting and storing water to be applied to a beneficial use upon the lands owned by such shareholders" (Finding XX, R. 56) and its by-laws provide:

> "Sec. 1. The proper irrigation of lands belonging to the stockholders of this Company shall always be this Company's primary object, and during the irrigating seasons no waters of this Company shall ever be used for any other purpose if such waters are necessary to properly irrigate the lands of the Company's stockholders." (R. 132)

ASSIGNMENTS OF ERROR RELIED UPON.

Plaintiff relies upon and will rely upon the following assignments of error: (Note: The Roman Numerals refer to the assignments and Arabic numbers to the respective pages of the record.)

II (70); III (70); IV (70); VII (71); VIII (71); IX (72); X (72); XI (72).

ARGUMENT.

I THE STOCK IN CONTROVERSY IS APPURTENANT TO THE LAND AND PASSED BY CONVEYANCE THEREOF.

Assignments of Error Involved:

"11.

"The Court erred in failing to find that said water stocks were and are appurtenant to the lands de-

scribed and referred to in said complaint now owned by plaintiff, and that said water stocks were transferred by the deed and mortgage of said lands."

"2.

"The Court erred in making and entering its decree that plaintiff is not entitled to a judgment declaring that said water stocks are subject to and conveyed by the lien of the real estate mortgage described in the complaint herein."

"3.

"The Court erred in not making and entering its judgment that plaintiff is the owner and entitled to the possession of said water stocks and that defendant has no right, title or interest therein or thereto or any lien thereon."

"4.

"The Court erred in not making and entering its decree that defendant surrender and deliver said water stocks to plaintiff."

"7.

"The Court erred in failing to find that, by virtue of the deed described in Finding X, said water stocks were sold, assigned and transferred by John G. Taylor to John G. Taylor, Inc., a corporation."

"8.

"The Court erred in failing to find that, by virtue of the mortgage referred to in Finding XI and XII, said water stocks were mortgaged by John G. Taylor, Inc. to The Reno National Bank."

Discussion:

The District Court rightly concluded that plaintiff as successor in ownership of the lands described in the complaint, is the owner of all water rights appurtenant thereto, including all rights to all means of transportation and storage of water such as dams, ditches, canals, and reservoirs, from the places or points of diversion to the places or points of use (Opinion, R. 44). With the exception of the Humboldt Lovelock Irrigation Light & Power Company, none of the companies, the stock of which is involved in this litigation, is possessed of any right to appropriate water. A decree of the state court which adjudicated the right to divert water from the natural flow of the Humboldt River, expressly provides that the rights therein confirmed are appurtenant to the place of use (R. 104), and the certificates which constitute the sole basis of the water rights possessed by the Humboldt Lovelock Irrigation Light & Power Company provide "that the right to water hereby determined is limited to the amount which can be beneficially used, not to exceed the amount above specified, *and the use is restricted to the* place where acquired and to the purpose for which acquired" (R. 109-112).

It is clear, therefore, that all water rights possessed by the owner of the stock involved in this suit are vested in the plaintiff, and under the doctrine enunciated by the Supreme Court of Nevada in *Prosole v. Steamboat Canal Company*, 37 Nev. 154, 140 Pac. 720, plaintiff is entitled to an easement in the ditches, reservoirs and other irrigation works of the respective companies for the diversion,

storage and conveyance of water from the place of diversion to the point of use upon plaintiff's land.

It is appellant's contention, however, that not only the right to receive water and to the use of the facilities of the respective companies for the diversion, storage and conveyance of water, are appurtenant to the land, but the stock itself is appurtenant to the land, and that the court erred in not so decreeing.

At the outset it should be noted that stock in the hands of one other than the plaintiff has nothing more than a nuisance value, since none of the companies has ever been operated for profit, or has ever derived any income except from assessments and charges collected from their stockholders in amounts sufficient to cover only the bare cost of maintenance and operation, or has ever engaged in any activity other than operating irrigation works for the benefit of and as common agent for the persons who have applied the water to a beneficial use, or has ever owned or possessed any assets except irrigation facilities which are subject to easements in favor of the persons who have applied the water to a beneficial use. In this aspect, the situation here is much the same as that described in *Twin Falls L. & W. Co. v. Twin Falls Canal Co.*, 7 Fed. Supp. 238 (affirmed C. C. A. 9, 79 Fed.(2) 431, certiorari denied 80 L. ed. 466), where the court said:

> "* * * Each share was then to represent a water right plus a proportionate interest in the property which plaintiff was to hold in trust for defendant until the project was transferred to the latter. But a water right can only exist when appropriated for and appurtenant to land upon which a beneficial use

> of the flow can be made. They were, when issued, only indicia of a water right dedicated to a definite parcel of land. If sold and appurtenant to land, each share constitutes a proportionate interest in the works and the water. Unsold, a share is of potential value only under peculiar conditions. It cannot be placed on the market like industrial stock and sold to the public at large. The purchaser must be in a position to apply the water represented to a specific tract of land, subject to irrigation from the original appropriation. The most potent factor is that when all the water appropriated has been applied to a beneficial use, a share of stock has no value, actual or potential, except for nuisance purposes."

On the other hand, unless plaintiff is adjudged and decreed to be the owner of the stock, plaintiff stands the risk of being deprived of the enjoyment of the very rights which the court held to be vested in plaintiff.

The articles of incorporation of the Humboldt-Lovelock Irrigation Light & Power Company, as the findings show, provide that holders of the Class A stock of that company shall be entitled to the preferential right to the first 10,000 acre feet of water stored in the Pitt-Taylor Reservoir annually, and that in the event that any Class A stock is transferred apart from the land of its owner to a person not the owner of Class A stock, the stock will immediately become Class B stock. It is probable that the right to receive water from the company is so far appurtenant to the land that it will follow the land even though the stock falls into the hands of other owners. But the articles of incorporation do not so provide,—on the contrary they

provide just the opposite. The court has no power in these proceedings to pass upon the validity of the company's articles, and unless the articles are invalid, then, in failing to decree that the plaintiff is the owner of the stock of the Humboldt-Lovelock Irrigation Light & Power Company, the court has placed it within the power of the defendant to deprive plaintiff of the preferential right to receive from the Humboldt-Lovelock Irrigation Light & Power Company the water which the court decided the plaintiff was entitled to receive.

The situation in reference to the ditch and canal companies is much the same. Plaintiff contended and the court held that the canals and other facilities for the diversion and transportation of water owned by these companies are subject to easements in favor of the owners of the lands which have been irrigated by means of water carried through such canals and ditches. The fact remains, however, that the right to have the water transported through the canals and ditches is evidenced by stock, and the stock has no value except as evidence of that right. Accordingly, in the event that the stock is ever transferred to a person ignorant of the rights of the plaintiff as adjudicated in this proceeding, it would be open for the purchaser of such stock to contend that the plaintiff is not entitled to the enjoyment of the right to the use of the ditches and easements. While such a contention might be without merit the adjudication made in this proceeding is not binding upon any of the respective companies, nor would an innocent purchaser of the stock be bound by it.

On the facts of the case as found by the court on unrefuted evidence, it is manifest that the court erred in

failing to decree plaintiff to be the owner of the stock free and clear of any claim of the defendant. The lands referred to in the complaint had a value of between $50 and $100 an acre if irrigated, but a value of only $2.50 an acre if not irrigated (R. 116); if deprived of water from the Pitt-Taylor Reservoir the lands would have a value of approximately one-half of the value placed upon them as irrigated lands (R. 117); the water carried in the ditches of the several ditch companies is devoted to a beneficial use upon the lands referred to in the bill of complaint (R. 54); there is no other way of irrigating the lands than through the ditches mentioned (R. 56); in making its loan to The Reno National Bank the Reconstruction Finance Corporation relied on the representations of the executive vice president of The Reno National Bank who was also the executive vice president of the Bank of Nevada Savings & Trust Company, that the lands were irrigated lands (R. 105).

In these circumstances the great weight of authority is that stock of corporations such as those here involved is appurtenant to the land.

In *In re Thomas Estate,* 147 Cal. 236, 81 Pac. 539, the California Supreme Court was called upon to decide whether stock in a water company similar to those companies involved in this suit should be distributed to the residuary legatee or to the devisee of the real estate. The court said:

> "No by-laws were adopted or certificates of stock issued in conformity with section 324 of the Civil Code as amended in 1895, providing that shares of stock in a water company, when the section is com-

plied with, shall be appurtenant to the land described in the certificate. But in this connection it is proper to note the fact that the corporation was formed, and its practice of distributing water to its stockholders established, more than three years before the passage of this amendment, and while it is true that nothing can be claimed by respondent under this law, it remains equally true that if before its enactment the water-right became appurtenant to the tract devised to her by other lawful means the law has no invalidating effect upon the right so acquired."

*   *   *   *   *   *   *   *

"* * * But it does not follow from this that the shares in controversy could not be appurtenant to the land. Conceding that they were so far personal property that the decedent might have transferred the water right by indorsement of the certificate, and thereby have severed the water-right from his land, it remains undeniably true that the right represented by the certificate—the right to receive eight hours' run of water in his turn—was appurtenant to the land, though deemed personal property with reference to the mode of transfer. In this view the stock certificate was merely the evidence of a water-right, which right, though capable of severance from the land to which it had become appurtenant, never was alienated or diverted by the decedent in his lifetime, but remained appurtenant to the six acre tract at the date of his will and at the time of his death. Therefore it was entirely proper to direct a transfer of the certificate to the respondent. It is her muniment of title and passes with the right of which it is the evidence, just as title deed should go to the distributee of real property.

"Nor is it any objection to the decree that the corporation may be interested in the disposition of its stock. It is not easy to see how a corporation is a necessary party to a controversy between third parties as to the ownership of particular shares of its stock; but if the Trabuca Water Company has a possible interest in this controversy it is not bound by the decree and remains free to maintain its adverse rights whenever they are drawn in question."

In re Johnson's Estate, 64 Utah 114, 228 Pac. 748, 750, was a case involving substantially similar facts. It was there held:

"Deceased left a water right represented by 56½ shares of the capital stock of the Union & Jordan Irr. Company, which, during his lifetime, had been used for the irrigation of the land owned and left by him. The water rights were appraised together with and as a part of the land. When Tract B was sold, 12½ shares of the water stock was transferred with it. Appellants, claiming the 44 remaining shares of water stock as an appurtenant to tract A of the real estate, prayed for its distribution to them. It was alleged and not denied that the water right was used in connection with the land, and that the land is of little or no value without the water right. The trial court found that the water right had been used for the irrigation of the lands owned by the testator, but that notwithstanding such use the same was personal property, and was not included in the devise to appellants. The question is whether a water right so owned and used will pass by the devise, without mention, with the land as an appurtenance.

"* * * The right to the use of water for irrigation is inseparately related to land. Without its continued

use upon land the right ceases. The customary practical presumption is that water rights used upon land are appurtenant to and a part of it. In this arid country, in most cases, 'farm lands' are valueless without water. It is inconceivable that the testator in this case intended to devise 'eleven acres above-mentioned of my farm land' and not include the water rights, upon the use of which depends the enjoyment and value of the property and without which it would scarcely be 'farm land'.

"Upon principle and authority we conclude that the water right referred to passed by the will as an appurtenance to the land selected by the executor, and that the same should be distributed to the appellants with the land.

"The judgment appealed from is reversed and set aside, and the district court directed to enter a decree in accordance with this decision awarding and distributing the whole of Tract A of the real estate, as described, together with the 44 shares of capital stock of the Union & Jordan Irrigation Company, representing the water right, to appellants. The decree should also include as an appurtenance to the land devised the right of way reserved across tract B to provide the necessary access from the public highway. With respect to the division of the property devised between appellants, the court will make such disposition in accordance with the will as the circumstances may require."

In *Ireton v. Idaho Irrigation Company,* 30 Idaho 310, 164 Pac. 687, it appeared that one Lansdon mortgaged to Boise Title & Trust Company 160 acres of land, together with all water rights owned by the mortgagor or belong-

ing or connected with the mortgaged premises. This mortgage was recorded on January 8, 1912 and the mortgaged property was on the 13th day of March of the same year sold upon the foreclosure of the mortgage, to the plaintiff Ireton. At the time of the execution of the mortgage Lansdon was the owner of certain shares of stock in Big Wood River Reservoir & Canal Co. Ltd. The shares represented a proportionate interest in certain irrigation works and entitled the holder thereof to certain quantities of water. Water was actually delivered to and applied to a beneficial use upon the mortgaged lands during 1911. Prior to the execution of the mortgage, namely, on April 1, 1910, the defendant Lansdon had executed an agreement conferring upon the defendant Idaho Irrigation Company, a lien upon the stock. This contract was not recorded, but after the recordation of the mortgage the stock was transferred on the books of the company, the stock certificates were transferred to the defendant. Both the plaintiff and defendant claimed the stock. The Supreme Court of Idaho held that the stock was appurtenant to the land and passed with the mortgage. In so doing the court said (p. 689):

> "It is contended by appellant that the shares of stock in the operating company are personal property, and that the water right passed by assignment of them, and did not become subject to the mortgage on the land. While shares of stock in an ordinary corporation, organized for profit, are personal property (Section 2747 Rev. Codes; State v. Dunlap, 28 Idaho 784, and cases therein cited on page 802, 156 Pac. 1141), and while this court has held shares in an irrigation company to be personal property (Watson

v. Molden, 10 Idaho 570, 79 Pac. 503) the fact must not be lost sight of that a water right is, as heretofore shown, real estate, and that in case of a mutual irrigation company, not organized for profit, but for the convenience of its members in the management of the irrigation system and in the distribution to them of water for use upon their lands in proportion to their respective interests, ownership of shares of stock in the corporation is but incidental to ownership of a water right. Such shares are muniments of title to the water right, are inseparable from it, and ownership of them passes with the title which they evidence. In re Thomas' Estate, 147 Cal. 236, 81 Pac. 539; Berg v. Yakima Valley Canal Co., 83 Wash. 451, 145 Pac. 619, L. R. A. 1915D, 292.

"It follows that, since respondents' mortgage is a prior lien upon the land and upon the water right appurtenant thereto, their claim to the shares of stock, which evidence that water right, is superior to that of appellant."

In *Yellowstone Valley Company v. Associated Mortgage Investors,* 88 Mont. 73, 290 Pac. 255, it appeared that the plaintiff owned two tracts of land and also stock in a mutual ditch company which provided irrigation for the said land. To secure loans, the plaintiff owner executed three mortgages on this land, each with a similar provision covering all irrigation rights, whether represented by capital stock of ditch or water companies or by direct ownership, and at the same time assigned the certificates representing the water rights to the mortgagee. In applying for the loans the plaintiff represented that the lands were irrigated and the mortgages were made on the basis of

irrigated land values. Without irrigation the lands were semi-arid in character and comparatively without value. The loans were based on the value of the lands as irrigated lands with water rights attached thereto; without water upon the lands the loan value upon the same would have approximated less than 30% of the loan value for irrigated lands; the lands at all times required all the water that could be secured from the ditch by the owners of the shares of stock. The plaintiff being in default as to the payment of the second and third of these mortgages, the holder of them foreclosed and bid the property in at the foreclosure sale. The sheriff's certificate of sale and deed failed to mention the appurtenances, water, water rights, or shares of stock, and this was a suit by the plaintiff to recover possession of the shares of stock or their value. It was held that while shares of stock in an ordinary corporation, organized for profit, are personal property, the fact could not be lost sight of that a water right is real estate, and that in the case of a mutual irrigation company, not operated for profit, as in this case, the ownership of shares of stock in the corporation is but incidental to the ownership of a water right, and ownership of them passes with the title which they evidence, subject, in this case, to the lien of the first mortgage. In so doing, the court said:

> "Plaintiff's theory is that the shares of stock in the Ditch Company are personal property, are not and cannot be appurtenant to the land; that the stock was hypothecated to the defendant by way of pledge, and, the pledge not being foreclosed when the defendant bid in the lands for the full amount of the

judgment, the stock was released from its pledge, and the debt being paid, the defendant has no interest therein.

"The determinative question is: Under the facts and circumstances shown, did the mortgage include the water rights represented by the shares of stock?

"* * * As is shown in the agreed statement of facts, the land in question was irrigated, and without irrigation was of little value. It appears conclusively that the water obtained from the canal of the Big Ditch Company was essential to the use of the land in question, and had been used thereon for thirty years or more. Upon the facts shown there can be no question that the water rights represented by the shares of stock in the Big Ditch Company were appurtenant to the lands. The authorities sustain this position. The fact that the certificates of stock—evidences of ownership of an interest in corporate property—are personal property, does not militate against this statement. Personal property can become an appurtenance to land without attachment or annexation. * * *

"The doctrine announced in the foregoing cases is suited to our history and conditions and meets with our approval. Defendant's counsel cite decisions from the Supreme Court of Colorado to sustain the decision of the lower court, but with these we are unable to agree.

"We do not overlook the point that whether a water right evidenced by shares of stock is appurtenant to the land upon which the water is used is a question of fact. But, upon the conceded facts, that question does not trouble us: clearly, the water is appurtenant to the land. Such being the case, the governing rule is that everything essential to

the beneficial use and enjoyment of the property conveyed is, in the absence of language indicating a different intention on the part of the grantor, to be considered as passing by the conveyance. Sheets v. Seldon, 2 Wall. 177, 17 L. ed. 822. The owner of land with an appurtenant water right may by appropriate conveyance, convey the land to one person and the water right to another. But, if he conveys the land without reservation, he also conveys the appurtenance and whatever is incidental to the land. He therefore conveys the appurtenant water rights, unless he expressly reserves them. If the water rights are represented by stock in an irrigation company such as the Big Ditch, he may, of course transfer the water right by mere assignment of the stock to one person and may convey the land by deed to another person. As a matter of course, controversies may arise in transactions of this nature in which it may be necessary to ascertain whether a grantor has intended to sell the water to one person and the land to another. But here, where it is clear that the mortgagor intended to convey both the land and the appurtenant water to the mortgagee to secure the payment of debt, the question does not arise." (page 257)

From the foregoing authorities we submit that the conclusion follows inevitably that the shares are muniments of title to the water rights which are admittedly vested in the plaintiff; that they are inseparable from those rights and that ownership of the shares passes with the title which they evidence. Such being the case, the shares passed with the conveyance of the land by John G. Taylor to John G. Taylor, Inc. on April 9, 1930 and

became subject to the mortgage of the lands executed by John G. Taylor, Inc. to The Reno National Bank and passed with the conveyance under the decree foreclosing that mortgage to plaintiff's predecessor in interest and by mesne conveyances to the plaintiff. The shares being appurtenant to the land and passing with the conveyance thereof, it is obvious that the bank, of which the defendant is the receiver, acquired no lien upon the stock by virtue of the pledge agreement executed by John G. Taylor more than two years after he had parted with ownership of the land to which they were appurtenant.

The District Court declined to decree the plaintiff to be the owner of the shares free from any claim of the defendant, on the ground that while the companies had no water rights, the stock might nevertheless represent some other more or less valuable rights, saying in this connection:

> "A reference to the articles of incorporation of the several companies do not disclose that they were organized for the sole or primary purpose of supplying water for irrigation of any particular land. In the case of the Humboldt Lovelock Light and Power Company, as indicated by its name, it was incorporated for other purposes in addition to that of storing and transporting water for irrigation. Stock therein might necessarily have a value for reasons wholly distinct from the matter of supplying water for irrigation of lands which, by its charter, is not confined to any definite tracts." (R. 42)

The District Court overlooked the fact that the by-laws of the Humboldt-Lovelock Irrigation Light & Power Company provided as follows:

> "Sec. 1. The proper irrigation of lands belonging to the stockholders of this Company shall always be this Company's primary object, and during the irrigating seasons no waters of this Company shall ever be used for any other purpose if such waters are necessary to properly irrigate the lands of the Company's stockholders." (R. 132)

Irrespective of this fact, however, it is well settled that the provisions of the Articles and By-Laws of the respective companies are immaterial in determining whether or not the shares are appurtenant to the lands. None of the companies has any tangible assets except works for the diversion, transportation and storage of water. These assets are subject to the right of its shareholders to the beneficial use thereof in proportion to their stockholdings, upon payment only of the cost of maintenance. The court has found and held that this right to the beneficial use of the assets of the respective companies, insofar as the same is represented by the shares involved in this litigation, is vested in the plaintiff, and not in the defendant. The Humboldt Lovelock Irrigation Light & Power Company, unlike the other companies, owns, in addition to works for the diversion and storage of water, certain water rights. But these rights the court found to be held by the company for the beneficial use of its shareholders, and that the plaintiff and not the defendant is entitled to the right evidenced by the stock in question to the beneficial use of the water. None of the companies have been operated for profit. Each of them has been operated as a common agency or instrumentality of the owners of the land served by their facilities. In these circumstances, the only right

which the stock can evidence other than the beneficial rights vested in the plaintiff, is a bare proportionate interest in the naked corporate franchise of the respective companies. This right can become valuable, if at all, only in the event that the companies engage in a business activity other than that of diverting, transporting and storing water. Since all of the companies have been in existence for more than a quarter of a century and none of them has engaged in any business or activity other than that of diverting, transporting and storing water, we submit that the right in the naked corporate franchise is so inconsequential and utterly speculative as to make it appropriate for the court to apply the doctrine of *de minimis non curat lex.*

Quite apart from this fact, however, the evidence establishes that so far as the actual operation of the several companies involved in this litigation is concerned, there is nothing to distinguish them from the water companies involved in the cases of *In re Johnson's Estate* (Utah) 228 Pac. 748; *Ireton v. Idaho Irrigation Co.* (Idaho) 164 Pac. 687; *Yellowstone Valley Co. v. Associated Mortgage Investors* (Montana) 290 Pac. 255; *In re Thomas' Estate* (Cal.) 81 Pac. 539, and other decisions, in which the courts have held the stock to be appurtenant to the land so as to entitle a transferee or mortgagee of the land to the stock certificates. Whether or not the Articles of Incorporation of the several companies involved in this action restrict them to diverting, transporting and storing water for the benefit of their stockholders, it must be borne in mind that the Articles of Incorporation are in no sense con-

trolling. The character of a corporation is to be determined by what it does and not by what it may do under its Articles of Incorporation. *Southern California Edison Co. v. R. R. Commission,* 194 Cal. 757, 763, 230 Pac. 661; *Del Mar Water Co. v. Eshleman,* 167 Cal. 666, 140 Pac. 591, 948.

In the case of *In re Thomas' Estate,* 147 Cal. 236, 81 Pac. 539, neither the Articles nor the By-Laws restricted the powers of the corporation there involved to diverting, transporting or storing water for the benefit of its stockholders. As a matter of fact, however, it had confined its activities to doing that and nothing more. The court said this had been done, not in pursuance of any by-laws formally inscribed in the records of the corporation, but solely in accordance with a common understanding of the stockholders. The court held that the stock was nevertheless appurtenant to the land so as to entitle a transferee of the land to the stock certificates.

It is, therefore, clear that notwithstanding the breadth or scope of the powers conferred upon the respective ditch and reservoir companies by their Articles and By-laws, the stock was and is appurtenant to the land so as to pass by conveyance thereof, with the result that defendant cannot, as against plaintiff, assert any interest in or lien upon the stock.

II. THE DEFENDANT NOT BEING AN INNOCENT PURCHASER OR ENCUMBRANCER FOR VALUE CANNOT ASSERT A LIEN ON THE STOCK ADVERSE TO PLAINTIFF.

(a) Assignments of Error Involved:

"10.

"The Court erred in failing to find that at the time the pledge agreement and loan described in Finding XV were made, John G. Taylor had no right, title or interest in or to said water stocks and that the interest of John G. Taylor, Inc., therein was subject to the mortgage theretofore made by John G. Taylor, Inc. to The Reno National Bank, and that the Bank of Nevada Savings & Trust Company at all said times had notice and knowledge that said water stocks had theretofore been sold by John G. Taylor to John G. Taylor, Inc. and by the latter mortgaged to The Reno National Bank." (R. 72)

"7.

"The Court erred in failing to find that, by virtue of the deed described in Finding X, said water stocks were sold, assigned and transferred by John G. Taylor to John G. Taylor, Inc., a corporation." (R. 71)

"8.

"The Court erred in failing to find that, by virtue of the mortgage referred to in Finding XI and XII, said water stocks were mortgaged by John G. Taylor, Inc. to The Reno National Bank." (R. 71)

"9.

"The Court erred in failing to find that, by virtue of the transactions described in Finding XXII, plain-

tiff is now the owner and entitled to the possession of said water stocks." (R. 72)

(b) Discussion:

Irrespective of whether the water stocks in question passed as an appurtenance to the lands now owned by appellant, the transactions shown by the record were sufficient to constitute a conveyance and mortgage of the stock, and by foreclosure of the mortgage appellant is the owner thereof. The record shows that the banks, of which respondent is receiver, had knowledge of these transactions prior to parting with anything of value, and therefore, not being bona fide purchasers without notice, the lien of respondent is subordinate to the rights of appellant.

John G. Taylor on June 9, 1930, was unquestionably the owner of both the lands and the water stocks. The waters stored and transmitted by the water companies for years previously had been used to irrigate the lands in question. The deed of June 9, 1930, from Taylor to John G. Taylor, Inc. conveyed "all shares of stock of any water corporation appurtenant to said lands *or the waters from which are used or have been used in connection with the irrigation or cultivation thereof*" (R. 79). As between the parties this transfer was valid and vested title in the stock to John G. Taylor, Inc. Although not transferred on the books of the water companies from the name of John G. Taylor, he held the stock thereafter merely as a trustee for the company.

12 *Fletcher, Cyclopedia Corporations* 293.

The record also shows that it was intended by the mortgage from John G. Taylor, Inc. to The Reno National

Bank to mortgage all the property which that company then owned. In this connection Mr. Sheehan testified (R. 146):

> "At the time we attempted to consolidate the Taylor loans in the early part of 1932, there was discussion of security with Mr. Taylor, and he furnished a list of all his property, both that of John G. Taylor, Inc. and of himself personally. I do not recall that the water stocks were specifically mentioned. He agreed to furnish as collateral everything that he had. He complied with our request that he furnish as collateral all the stock in the various corporations. * * *
>
> "There was considerable discussion in the early part of 1932 about the consolidation of the Taylor loans, which were previously unsecured. Several discussions were had, both with Mr. Taylor and with the officials of the Reconstruction Finance Corporation. It was repeatedly stated that all of the property of John G. Taylor, Inc. and John G. Taylor was to be put up as security. Following these conversations the loans were consolidated into a single loan of $700,000, represented by note from John G. Taylor, Inc. to The Reno National Bank, secured by chattel mortgage and real estate mortgage. *At the time the real estate mortgage was being prepared, Mr. Taylor was told that he was expected to give all the security which his company had, and he agreed to do so.* This note and the mortgages were later assigned to the Reconstruction Finance Corporation, which advanced to The Reno National Bank more than One Million Dollars."

Irrespective of the sufficiency of the description in that mortgage, and irrespective of compliance with statutory

requirements as to the form of the mortgage, this mortgage was good as between the parties (*Jones on Chattel Mortgages*, 5th ed., p. 3; 11 *C. J.* 454).

Section 987, Compiled Laws of Nevada, which provides that a mortgage of chattels "is void as against creditors of the mortgagor and subsequent purchasers and encumbrancers of the property in good faith and for value" unless certain affidavits (admittedly not here present) be attached, is not here involved, since it appears that the state banks for which defendant is receiver had notice and knowledge prior to the time that they parted with anything of value that the water stocks in question were no longer owned by Taylor but were subject to the mortgage held by the R. F. C. made by John G. Taylor, Inc.

Section 987, *Nevada Compiled Laws*, has not in its present form been construed by the Nevada courts. It is, however, identical in terms with Section 2957 of the California Civil Code. The California statute has been construed as available only to one who at the time he parted with value had no knowledge of a prior mortgage not executed with the requisite formalities.

> *Works v. Merritt*, 105 Cal. 467;
> *Treat v. Burns*, 216 Cal. 216.

Such statutes have also been construed as applicable only to tangible personal property and not applying to corporate stocks or other choses in action.

> *Westinghouse etc. Co. v. Brooklyn R. T. Co.*, 288 Fed. 221;
> *Jones on Chattel Mortgages* (5th ed.), Sec. 278.

No evidence was introduced respecting the alleged attachment liens of the three state banks for which respondent was receiver, and the only lien claimed by respondent as to which any evidence is shown of record is that derived through the Bank of Nevada Savings & Trust Company under an alleged pledge agreement from John G. Taylor personally. The record shows that this pledge agreement was made approximately two months after the transaction between John G. Taylor, Inc. and The Reno National Bank and after assignment of that mortgage to the R. F. C. It was not until several weeks after the date of the pledge agreement that the Bank of Nevada Savings & Trust Company made any advances or parted with value. At the time the pledge agreement was taken and at the time the Nevada Bank loaned money on the strength thereof, that bank had knowledge of the prior mortgage.

The Nevada Bank was owned by the same stockholders, occupied the same banking rooms and had the same officers, directors and personnel as The Reno National Bank. The Nevada Bank transaction was handled by the same Mr. Sheehan who had handled the transaction between John G. Taylor, Inc. and The Reno National Bank and the assignment of that mortgage to the R. F. C. Sheehan testified that he knew that The Reno National Bank mortgage was intended to cover everything which John G. Taylor, Inc. possessed; that the lands in question attained their value primarily by virtue of their possibility of irrigation derived through the facilities of the water companies whose stocks are here involved. Sheehan testified that in connection with the subsequent Nevada Bank

transaction he did not see (and therefore could not have relied upon) the pledge agreement signed by Taylor personally, on which defendant's lien is founded. In fact, Sheehan testified that he had not seen the certificates representing these stocks throughout that period until he saw them at the trial. His signature appears as a witness to the endorsement of John G. Taylor on the stock certificates in question (R. 143). In light of his testimony, Sheehan could have witnessed Taylor's signature only in connection with some antecedent transaction, confirming his description of The Reno National Bank transaction, as to which he testified (R. 147):

> "At the time the real estate mortgage was being prepared Mr. Taylor was told that he was expected to give all the security which his company had, and he agreed to do so."

The knowledge acquired by Sheehan, who was the sole representative of the Nevada Bank in the transaction relied on by respondent, cannot be repudiated merely because Sheehan acquired that knowledge while acting for The Reno National Bank. The knowledge possessed by an agent of two or more corporations is attributable to each irrespective of the capacity in which such knowledge was acquired.

> *Restatement of the Law of Agency*, §276;
> *Cook v. American T. & W. Co.* (R. I.) 65 Atl. 641;
> *Louisville Trust Co. v. Louisville R. R. Co.*, 75 Fed. 433.

The deed of June 9, 1930, was sufficient to pass title to the water stocks from Taylor to John G. Taylor, Inc. The

mortgage of March 12, 1932 was intended to and did mortgage that stock to The Reno National Bank and by foreclosure of that mortgage appellant is now the owner of the stock. While it is true that when the stock was permitted to remain in the name of John G. Taylor individually, a bona fide purchaser for value of the stock from Taylor might be protected, and while such a purchaser would be entitled to the benefit of Section 987, *Nevada Compiled Laws,* in view of the fact that the mortgage did not contain the affidavit thereby required, respondent is not such a bona fide purchaser. As receiver he can stand in no better place than the banks for which he is acting. These banks at the time they parted with value had knowledge of the conveyance of the stock from Taylor to the corporation and of the mortgage by the corporation to The Reno National Bank. Having actual knowledge of these transactions, informalities or irregularities in the transfer of the mortgage cannot be relied on and liens asserted based on transactions entered into with such knowledge are subordinate to the interest of the prior purchaser or encumbrancer. Appellant, therefore, having succeeded, through foreclosure of The Reno National Bank mortgage, to the title to the property affected thereby, is now the owner of the stock and entitled to its possession as against respondent.

It is respectfully submitted that the decree should be reversed, with instructions to enter a decree adjudging appellant to be the owner of the stocks described in the

complaint, free from any claim of respondent, and directing the surrender of such stocks to appellant.

Respectfully submitted,

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No. 9015

United States Circuit Court of Appeals

For the Ninth Circuit

Pacific States Savings & Loan Company, a corporation, substituted for Reconstruction Finance Corporation, a corporation,
Appellant,

vs.

Leo F. Schmitt, as Receiver of Bank of Nevada Savings & Trust Company, Carson Valley Bank, Tonopah Banking Corporation and Virginia City Bank,
Appellees.

BRIEF FOR APPELLEES

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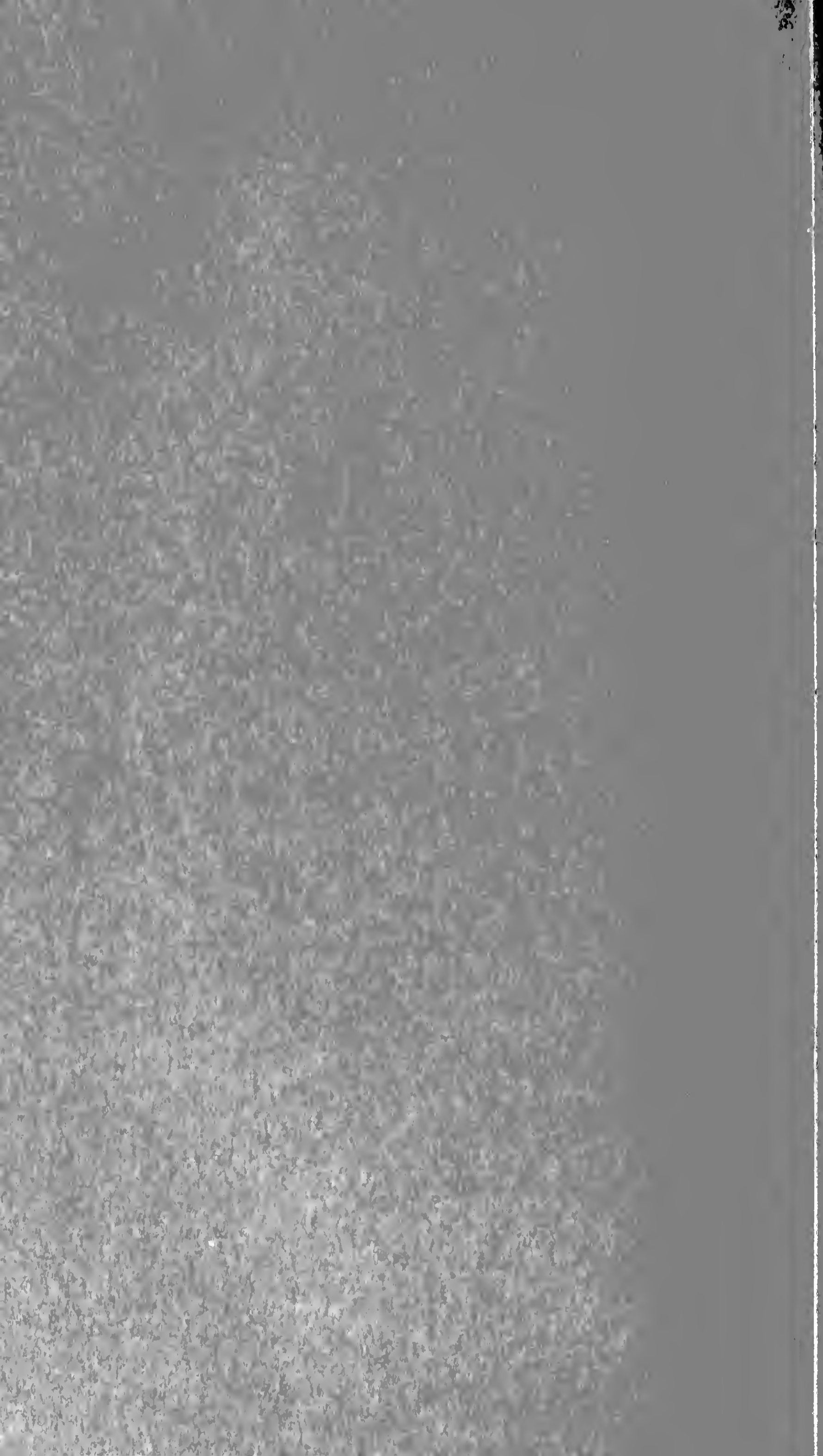

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No. 9015

United States Circuit Court of Appeals

For the Ninth Circuit

PACIFIC STATES SAVINGS & LOAN COMPANY, a corporation, substituted for Reconstruction Finance Corporation, a corporation,
Appellant,

vs.

LEO F. SCHMITT, as Receiver of BANK OF NEVADA SAVINGS & TRUST COMPANY, CARSON VALLEY BANK, TONOPAH BANKING CORPORATION and VIRGINIA CITY BANK,
Appellees.

BRIEF FOR APPELLEES

The Suit Is Inequitable and Unconscionable

As was stated by the learned trial Judge in his Opinion upon the Merits (Tr. Rec. 35), "This is a suit in equity." Though the Bill of Complaint was filed on the equity side of the Court, the facts disclosed by the record establish the suit to be inequitable and uncon-

scionable. While the trial Court reached its conclusion in favor of Appellees upon the law of the case, it is respectfully submitted that consideration of equitable principles involved is primarily essential.

The suit was brought to recover certain certificates of stock in the possession of the appellee receiver. The first pertinent inquiry is, how did the Receiver come into possession of these stock certificates? It is admitted that they were among the files of the Bank of Nevada Savings & Trust Company when the Receiver took over its assets. (Tr. Rec. 149). In other words, they were obtained while the bank was a going institution, and while the Reno National Bank (whose successor in interest brought this suit) was likewise an open operating bank. Therefore, it seems proper to state, that whether this suit is equitable or not depends upon the situation that existed while both banks were open and doing a general banking business and prior to respective receiverships, assignment or substitutions. What was this situation?

A receiver stands in no different position as to the obligations of a bank at the time of his appointment than the bank.

Organ v. Winnemucca State Bank & Trust Co.,

26 Pac. Rep. (2) Nev. 237, 238.

Preliminarily, it is most important to observe that both banks were operated and controlled by a common and interlocking director. As pleaded in the complaint (Tr. Rec. 9-10) and in defendants' answer (Tr. Rec. 27), and as Mr. Jerry Sheehan, vice-president and director of both banks, testified, "The personnel and directorate of both banks was the same, the same per-

sons acting in an equivalent capacity for both throughout the period I was there. Both banks conducted their business in the same banking room." (Tr. Rec. 145. See also Appellant's Brief, page 8). Therefore, this common management being a conceded fact, is it proper and legal that one bank may be deliberately managed to the detriment of the other and its depositors? Or, to put it another way, is it legal and proper that one bank may deliberately take a financial benefit at the expense of the other? If the answer be in the affirmative, then this suit is at least equitable. If it be in the negative, then the suit is inequitable and unconscionable and should be dismissed. Keeping in mind the common directorate, what are briefly the essential conceded facts surrounding the instant transaction?

The Reno National Bank loaned John G. Taylor, Inc., $700,000 and took its note and real estate mortgage. The transaction was handled by Mr. Jerry Sheehan, vice-president and director of this bank and the Bank of Nevada Savings & Trust Company. Later, the same corporation wanted to borrow $32,500.00 more. Its president, John G. Taylor, interviewed the same Mr. Sheehan, and was told substantially that the corporation could have the money, but it would be loaned out of the Bank of Nevada Savings & Trust Company. Security was required, and Mr. Taylor pledged his personally owned, duly endorsed stock certificates as acceptable security. These are the stock certificates in controversy here. Mr. Sheehan himself witnessed Mr. Taylor's endorsement signatures. He also initialed the notes and made notation in his own hand-writing to indicate the purpose of the loan. (Tr. Rec. 145). The stock certificates were placed in the files of that bank and the money loaned was taken out of that bank, and though the loan was manifestly approved by the com-

mon directorate and its common vice-president, Mr. Sheehan, the Reno National Bank, through its successors and substituted party in interest, is suing here to deprive the other bank of the only securities it had for the loan, and permitting that bank to hold the empty sack. Though in effect, the Reno National Bank through the common directorate authorized the loan and instructed the appellee bank to accept the security, it now sues to recover the security and makes no tender or offer to reimburse the appellee bank. Such a proceeding, it is respectfully submitted, is revolting to all principles of equity. More than this, the common directorate owed an equal duty of fairness and protection to both banks. By approving the loan from the Bank of Nevada and accepting the security, it could not properly in law authorize the Reno National Bank to sue for the possession of the security unless at least it first reimbursed in full the former bank for the money taken out of its vaults. The duty of a common directorate of two banking institutions has been well defined by the Supreme Court of the United States and Circuit and District Courts of the Ninth Circuit:

> "The relation of directors to corporations is of such a fiduciary nature that transactions between boards having common members are regarded as jealously by the law as are personal dealings between a director and his corporation, and where the fairness of such transactions is challenged the burden is upon those who would maintain them to show their entire fairness and where a sale is involved the full adequacy of the consideration. Especially is this true where a common director is dominating in influence or in character. This court has been consistently emphatic in the application of this rule, which, it has declared, is founded in soundest morality, and we now add in the soundest business policy. Twin-Lick Oil Co. v. Marbury, 91 U. S. 587, 588; Thomas v. Brownville, Ft. Kearney & Pacific R. R. Co., 109 U. S. 522; Wardell v. Rail-

road Co., 103 U. S. 651, 658; Corsicana National Bank v. Johnson, 251, U. S. 68, 90."

Geddes v. Anaconda Mining Co., 254 U. S. 590, 599,65 Law Ed. 425, Citation from page 432.

The Geddes case, supra, was an appeal from the Ninth Circuit Court of Appeals, and while the decision of the latter court (245 Fed. 225) was reversed, there was no substantial disagreement respecting the rule applicable in cases of interlocking directors. (See page 235). See also opinions in same case by Hunt, Circuit Judge, sitting as trial judge, 197 Fed. 860, 864, and Bourquin District Judge, 222 Fed. 133. See also Idaho-Oregon Light & P. Co. v. State Bank of Chicago, 224 Fed 39; 14A Cor. Jur. 125.

In a former opinion in another case in the United States District Court for the District of Nevada, involving the same appellee receiver as plaintiff, and the Reconstruction Finance Corporation as defendant, the same question of common and interlocking directors was involved. In an opinion rendered by Judge Norcross, there appears the following excerpt:

"It appears from the evidence that all of the several banks involved are a part of what is referred to in the briefs as the Wingfield chain of banks. It appears from the record that the president and vice-president of the Reno National Bank were respectively president and vice-president of all of the other banks referred to in the complaint. It also appears from the evidence that the Board of Directors of all of the banks mentioned in the complaint were the same, or at least a majority thereof were members of the Board of Directors of the Reno National Bank. The rule is well settled that where two or more corporations are controlled by the same or substantially the same board of directors, in transactions between such corporations so dominated, in order for the same to be enforce-

> able against a corporation a party to any such agreement, it must appear that the agreement is advantageous to the corporation against whom such agreement or obligation is sought to be enforced."

Schmitt v. Reconstruction Finance Corporation

20 Fed. Supp. 813.

A further brief analysis of the instant situation is as follows:

The Reno National Bank entered into a contractual relation with John G. Taylor, Inc., by and through which it loaned the corporation a substantial sum of money and took its security. Later, through the same board of directors, the Bank of Nevada Savings & Trust Company entered into a contractual relation with the same corporation, by and through which it loaned the corporation a substantial sum of money and took approved security. The Reno National Bank, through this suit, is now attempting to take away from the Bank of Nevada the benefits (the security) derived through the contractual relation and placing these benefits with the Reno National Bank. It is believed that in all conscience, law and equity, this may not be done.

WHAT THE APPELLANT FIRST CONTENDS

The equitable considerations above submitted are not presented or argued in appellant's opening brief. It first contends that its predecessor in interest had a real estate mortgage, which, it asserts, carried with it a pledge of the stock in controversy here. This we respectfully deny, and the point will later be discussed in detail. Attention, however, is invited to the established fact that the stock was never assigned or delivered, as such, to the Reno National Bank, for the record conclusively shows that it was pledged definitely to the Bank of Nevada. Further, the record is clear that during the entire transaction, the Reno National Bank never treated the stock as pledged to it, nor did it ever make demand that it be pledged. On the contrary, through its common directorate it actively considered the stock as unpledged and accepted it as security for a loan from another bank over which it had exclusive control. Is it not clear, therefore, that whatever possible claim it may have had to the stock as security, it manifestly waived and forfeited by not only yielding the stock to the other bank, but approving it as security for the loan? As has heretofore been stated, an attempt to repudiate that transaction by suit and further to attempt to take away what had been authoritatively given and upon which a substantial amount of money had been loaned, is evidence of the utmost bad faith. If the appellant prevails, the common directorate will have accomplished two results. First, it will add to the assets of one bank by taking away security without consideration from another bank. Second, it will diminish the assets of one bank to the benefit of the other, and in addition, cause the one bank to suffer a loss of $32,500.00, plus interest due. It is respectively submit-

ted that such conduct by a common directorate is condemned by the Federal Courts of this country.

Lack of equities and the unconscionable nature of this suit were specially pleaded by the Fourth, Further, Separate and Affirmative Defense set up in defendants Answer (Tr. Rec. 30-31).

The Mortgage Relied Upon by Appellant, with Respect to Personal Property, Is Absolutely Void As Against Creditors.

We have urged the equitable considerations involved as conclusive against the plaintiff-appellant; and though the appellant relies in part for recovery upon the construction of the real estate mortgage introduced in evidence herein, it is respectfully urged that equity estops and forbids recovery however the mortgage might be construed. It is, however, contended that the real estate mortgage includes by blanket reference, all personal property owned by John G. Taylor, Inc., and that this personal property includes the shares of stock in controversy here. This contention likewise may not be sustained.

It is respectfully submitted that this real estate mortgage, insofar as it includes personal property, is absolutely void as against creditors, and as against these defendants who are confessedly creditors. As respecting personal property, the mortgage was not executed in conformity with the statutes and laws of the State of Nevada in that it bears no affidavits that the mortgage was made in good faith and not for the purpose of hindering, delaying, or defrauding creditors. (Statement Evidence in Tr. Rec. 81). It is, therefore, urged, that as against the defendants, the mortgage carried

nothing by way of encumbrance except the real estate, and no claim of lien for any personal property included therein may be successfully made against the defendant.

The statutes of Nevada with respect to chattel mortgages provide, among other things, as follows:

> "MORTGAGE VOID UNLESS MADE IN GOOD FAITH AND RECORDED.
>
> Sec. 3. A mortgage of personal property is void as against creditors of the mortgagor and subsequent purchasers or incumbrancers of the mortgaged property in good faith and for value, unless:
>
> 1. There is appended or annexed thereto the affidavits of the mortgagors and mortgagee, or some person in their behalf, setting forth that said mortgage is made in good faith, and without any design to hinder, delay or defraud creditors.
>
> 2. It is acknowledged or proved, certified and recorded in like manner as grants of real property.
>
> *N. C. L.* 1929, Vol. 1, Sec. 987.

The mortgage in question here contains no appended or annexed affidavits of the mortgagor and mortgagee or some person in their behalf setting forth that the said mortgage was made in good faith and without any design to hinder, delay or defraud creditors. That being the fact, it must be declared, under the statute just cited, that with respect to the personal property, it is void against the defendants in this suit.

> "By statute in many jurisdictions, the mortgage must be verified as to its good faith, consideration, etc., by a sufficient affidavit annexed to and recorded with the mortgage to make it valid against creditors of the mortgagor and purchasers of the property covered by the mortgage, and the omission is not remedied by a subsequent affidavit without again recording the instrument or by an affidavit of renewal stating the requisite facts, including the

averment of good faith. So, where the chattel mortgagor neither signed the affidavit required by statute nor was sworn to the facts therein required, it doesn't render the instrument valid that he went before a notary public for the purpose and with the intent of performing every act required by law to make the instrument a valid mortgage. But between the parties and as to third persons who have no rights against the mortgagor, no affidavit is necessary. As these statutes are in derogation of the common law, they must be strictly construed. No affidavit describing the debt for which the mortgage was given is necessary to a common-law mortgage. The want of an affidavit or a defective one, is cured where the mortgagee takes possession of the property before the rights of third persons intervene."

11 C. J. Page 481, Sec. 125.

This principle has been declared by adjudications of courts of last resort in various jurisdictions and it would be superflous to burden the record with a lengthy citation of authorities. A large number of them are cited in the footnotes of the text hereinabove quoted. The rule applies with equal force to chattel mortgages as such and to so-called real estate mortgages including a description of personal property.

"There was a large quantity of personal property taken possession of by the receiver, and it appears a considerable portion thereof realized upon, and the funds have been used by the receiver in his management and control of the properties. There was no affidavit of the mortgagor that any mortgage of personal property was made in good faith and without any design to hinder, delay, and defraud creditors, and it was not recorded as a chattel mortgage." Section 1648 1 Hill's Code is as follows: 'A mortgage of personal property is void as against creditors of the mortgagor or subsequent purchasers, and incumbrances of the property for value and in good faith, unless it is accompanied by the affidavit of the mortgagor that

it is made in good faith, and without any design to hinder, delay or defraud creditors, and it is acknowledged and recorded in the same manner as is required by law in conveyance of real property.' Section 1649 provides: 'A mortgage of personal property must be recorded in the office of the county auditor in which the mortgaged property is situated, in a book kept exclusively for that purpose.' The plain literal meaning of these sections is against the contention of plaintiff that it has any lien whatever upon the personal property in the possession of the receiver, as against these petitioners. There is no evidence whatever that the petitioners had any notice of the existence of any chattel mortgage in favor of the plaintiff. Counsel for plaintiff and receiver argued that, as petitioners as creditors have not negatived notice of knowledge on their part, it should be inferred against them: but this would be a novel rule, and one that we have never seen applied. Such allegation and proof of notice should come from the one claiming the personal property under the alleged mortgage. But we are not prepared to decide that in any view, there could be here a chattel mortgage as against these creditors. In Willamette Casket Co. v. Cross Undertaking Co. 12 Wash. 190, 40 Pac. 729, this court held a mortgage void, as to subsequent creditors which was not recorded in a reasonable time after its execution. The Court said "The language of the statute and these authorities satisfy us that it was the intention of the legislature to give no preference to a chattel mortgagee over the claims of creditors who should become such after its execution, unless it was recorded within a reasonable time after its execution."

(Citing several authorities)

48 Pac. 333, particularly at Page 338.

It will be observed from an examination of the case just cited that the mortgage declared void, as to its effect upon personal property included therein, was in fact a real estate mortgage, and to that extend was similar to the character of mortgage relied upon by

the plaintiff in the case at bar. It is evident from the evidence, that the Reno National Bank acquired its real estate mortgage from John G. Taylor, Inc. without the necessary affidavits, as to the personal property included, being appended or annexed thereto. That subsequently, John G. Taylor, Inc. became a debtor of the Bank of Nevada Savings & Trust Company in the sum of $32,500.00 and that John G. Taylor deposited by way of pledge with said bank, water stock in controversy here, as collateral. Up to that time, no demand had been made upon the Taylor corporation by the Reno National Bank for the delivery of the stock nor had any demand been made by the plaintiff assignee in this case, upon the Reno National Bank for the delivery of the stock, nor has any demand been made by plaintiff assignee upon John G. Taylor, or upon John G. Taylor, Inc. for delivery of the stock up to the filing of the present suit. If any such demands were made, no evidence has been introduced to establish them. In other words, the Reno National Bank and its assignee, the Reconstruction Finance Corporation, plaintiff, not only consented and authorized the pledging of the stock to the Bank of Nevada Savings & Trust Company, but both are in addition to this, in possession of a real estate mortgage which, in the law, establishes no lien upon the stock. Before the suit was brought or before any contention at all arose with respect to the possession of this stock, the Bank of Nevada Savings & Trust Company became a creditor of John G. Taylor, Inc., through a loan of $32,500.00 and holds the note of John G. Taylor, Inc. and John G. Taylor together with the pledged stock and a collateral agreement. As such, Bank of Nevada Savings & Trust Company and the receiver together with the attaching lien creditors-defendants became intervening creditors in possession of collateral absolutely unencumbered.

It therefore follows, that the Reno National Bank never had any claim upon the stock through the so-called real estate mortgage, that the mortgage was void as to the personal property included as against the claim of the intervening creditor, Bank of Nevada Savings & Trust Company, and the attaching lien creditors-defendants, and that the plaintiff assignee, the Reconstruction Finance Corporation, stands in the same position as its assignor, the Reno National Bank.

In the case of Alferitz, et al. vs. Scott, 62 Pac. 735, a California case, the Court, on page 736, holds as follows:

> "When the mortgage was recorded, it had attached to it no affidavit of the mortgagee, or of any person in his behalf, stating that the mortgage was made in good faith, and without any design to hinder, delay or defraud creditors." Subdivision I Sec. 2957, Cov. Code reads as follows: "A mortgage of personal property is void as against creditors of the mortgagor and subsequent purchasers and incumbrancers of the property in good faith and for value, unless, 1. It is accompanied by the affidavit of all the parties thereto that it was made in good faith and without any design to hinder, delay or defraud creditors." This section of the code requires the affidavit of all the parties to the mortgage to accompany it when recorded, but not necessarily all the members of a corporation or co-partnership where the mortgage is made to or by such corporation or co-partnership. Bank vs. Owens 121 Cal. 223, 53 Pac. 552. The subsequent affidavit made by the mortgagee without recording the instrument was not a compliance with the statute, and gave no additional validity to the mortgage; and, had it been recorded after the affidavit of the mortgagee was attached thereto, it would have been noticed only from the date of recordation. The creditors of the mortgagors had notice of no other mortgage than such as they found recorded, and, lacking as it did the essential already pointed out, they could proceed by attachment against the prop-

> erty then in possession of the mortgagors regardless of the alleged lien. The judgment was affirmed."

And so it is here. The mortgage upon which plaintiff relies, did not contain the necessary affidavits required by the statute. The receiver of the various state banks as is admitted by the pleadings, attached the stock, which was not in law a part of the mortgage, for the reason, among others, that the mortgage did not contain the necessary statutory affidavits. It was, therefore, void as to the receiver, and the attaching defendants herein. The property, namely, the water stock in question, was in the possession of an independent third party, and so far as the mortgage in question is concerned, it was free from all liens and encumbrances and subject to pledge.

A matter of further great vital importance, which must be taken into consideration, is that it was not John G. Taylor, Inc., but John G. Taylor personally, who pledged his stock as security for the loan by the Bank of Nevada Savings & Trust Co. This corporation mortgage gave no information whatever as to the personal holdings of John G. Taylor. The mortgage only affected the property of the corporation so that under no circumstances may it be assumed that the mortgage in question gave any notice to attaching creditors or third parties or anyone else, as to any liens or encumbrances upon any property, real or personal, of any kind, character or nature, held, owned, or possessed by John G. Taylor personally.

And, Again, the Real Estate Mortgage, With Respect to Personal Property Is Void as to Creditors for Lack of Certainty.

Reliance is placed by plaintiff upon the contention that the mortgage included the water stock in question here because the mortgage, by a blanket clause, mortgages all personal property held by the corporation. By weight of authority, and by the law pronounced in the State of Nevada, this description is far from adequate so as to identify the personal property intended. The natural inference to be derived from such a blanket description, would be that the personal property referred to is such personal property as is situated upon or approximately connected with the real property described. It would be a far stretch of imagination to assume that such a description would cause inquiry with respect to certificates of stock held by an individual, who was not even the mortgagor, or that the corporation mortgagor itself was the owner of shares of stock subject to the mortgage. As a matter of fact, if a prospective creditor had known of the existence of the so-called water stock corporations and had examined the books and records of these corporations to ascertain the owners of the stock, he would have found that no stock had ever been issued to John G. Taylor, Inc., but that it had been issued, transferred and delivered to John G. Taylor personally and that he was the holder, possessor and owner thereof.

In a case decided by Judge Farrington, former United States District Judge for the District of Nevada, it was held, that the description of property in a chattel mortgage, then under consideration, was insufficient to exact any adverse rights as against creditors and others.

In re Petersen
252 Fed. 850

> "The fact that the parties to the mortgage are able to identify the property, or to state what stock is to be covered thereby, is not what is required. The description in the mortgage must direct the attention to some source of information beyond the words of the parties themselves. It must furnish the data by which the mortgaged chattels may be identified."

Barret v. Fisch 76 Iowa 553
41 N. W. 310
14 Am. St. Rep. 238, 239

> "If the oral testimony of the parties was sufficient, as the mortgagee here claims, few descriptions would or could be fatally defective, and the purpose of requiring chattel mortgages to be recorded in order to give notice to the public would be defeated."

The reported opinion cites numerous authorities in support of the doctrine that

> "The suggestion which indicates the line of inquiry must come from the mortgage itself, and cannot rest alone in the minds of the mortgagor and mortgagee."

In Re Petersen 252 Fed. 849
See also Street v. Sederburg, 92 Pac. 29
Simonson v. McHenry, 92 Pac. 906
Souders v. Voorhees, 12 Pac. 526

The appellant, in opposition to this contention, asserts in its brief that "The defendant not being an innocent purchaser or incumbrancer for value cannot assert a lien on the stock adverse to plaintiff." (Brief for Appellant, Page 30). This contention, because of the common directorate and the peculiar facts involved, leads to an absurdity. Certainly the Bank of Nevada Savings & Trust Co. as a creditor had notice of the mortgage, but this notice was had through the common directorate of both banks. If, as urged, the common directorate

had knowledge of the mortgage and likewise of the Bank of Nevada Savings & Trust Co. loan, and accepted the collateral for the latter bank and approved the deal, then how may the present plaintiff appellant in all equity repudiate the transaction by insisting that the Bank of Nevada was not an innocent incumbrancer for value? If the legal doctrine of "innocence" be applied, it could be asserted with much force in that the depositors of the Bank of Nevada were innocent that their money, which had been loaned upon security approved by a common directorate, was to be later lost because of a change of front of said directorate. These depositors were undoubtedly innocent of the fact that later the common directorate would, in effect, bring a suit through an assignee to take away from them the security which they once approved. In a word, if the plaintiff appellant insists that notice was given, then undoubtedly, in the light of the established facts, it waived and gave up and surrendered all claim of lien to the Bank of Nevada Savings & Trust Co.

John G. Taylor, Inc., Never Owned the Water Stock and Could Not Have Mortgaged It. The Deed From John G. Taylor to the Corporation Did Not Pass Title to the Stock.

It is contended by the plaintiff that because the deed of conveyance from John G. Taylor to John G. Taylor, Inc. included reference to the so-called water stock, that the corporation acquired title to this stock. Under the law of Nevada, this contention may not be successfully maintained. The evidence shows conclusively and without contradiction that John G. Taylor never delivered any water stock or the certificates therein to the corporation. The evidence shows that he held them in his private possession, that he treated them as his own, that he actually pledged them to the Bank of Nevada Savings & Trust Co. and that they were never transferred upon the books of the various corporations which they represented. These undisputed facts determine definitely that the corporation never received title to the stock and therefore could not possibly have mortaged it to the Reno National Bank. The certificates of stock are confessedly personal property. In the absence of any delivery thereof and followed by an actual and continued change of possession, his so-called sale of the stock to the corporation, without such delivery and change of possession is conclusive evidence of fraud as against the defendant receiver, the Bank of Nevada Savings & Trust Co. and attaching-defendants.

Section 1536, Vol. 1, Nevada Compiled Laws provides as follows:

> "SALE, WHEN EVIDENCE OF FRAUD,Sec.64
>
> Every sale made by a vendor of goods and chattels in his possession, or under his control, and

every assignment of goods and chattels, unless the same be accompanied by an immediate delivery, and be followed by an actual and continued change of possession of things sold or assigned, shall be conclusive evidence of fraud, as against the creditors of the vendor, or the creditors of the person making such assignment, or subsequent purchasers in good faith."

Section 1537 Ibid, provides as follows:

"CREDITOR DEFINED. Sec. 65. The term "creditors" as used in the last section, shall be construed to include all persons who shall be creditors of the vendor or assignor at any time while such goods and chattels shall remain in his possession or under his control."

Plaintiff contends that delivery may be either actual or constructive, and that the delivery of the deed constituted a constructive delivery of the stock. This contention may be properly made under certain conditions and circumstances, but it is inapplicable here, as will later be pointed out, and is not supported by the statutes of Nevada, or the adjudications of the Supreme Court of Nevada.

In an early case decided by the Supreme Court of Nevada, namely Doak vs. Brubaker, 1 Nevada 218, the Court holds among other things, as follows:

"Delivery of possession of personal property may be either actual or constructive, and it seems that an actual delivery is contemplated by the statute, unless, indeed, such delivery were impossible or extremely inconvenient, in which case a symbolical delivery would doubtless be sufficient. If property mortgaged could be transferred to the mortgagee by a mere constructive or symbolical delivery, where actual delivery can be readily made, practically these sections of the statute would be entirely nugatory, and their object totally defeated. There being no means by which the public can ascertain whether personal property is mortgaged or not, except by the change of possession,

> and the person in possession, and exercising ownership over it, being presumed to be the owner, if after being mortgaged it were allowed to remain in the possession of the mortgagor, mortgage after mortgage might readily be placed upon it. This being the very evil sought to be remedied by the statute, we think such a construction should be put upon it as will most effectually carry out its object. To accomplish this purpose, and to secure probity and fair dealing in transactions of this kind, the opportunities of fraud must be removed. There must not only be a transfer of the right of the property, but the possession must accompany it."

This decision not only establishes that there was no sale of the water stock by John G. Taylor to John G. Taylor, Inc., because of a lack of delivery of the stock in question, but it also establishes that even if the corporation had acquired title to the water stock, it didn't mortgage it to the Reno National Bank because there was no delivery of it and change of possession. It may not be contended that it was inconvenient for Taylor to have made delivery of the stock to the corporation or that it was in the possession of a third party, or that it was so cumbersome or bulky that he could not conveniently have delivered it. There are no excuses or reasons to apply the doctrine of constructive delivery. No such reason was disclosed by the evidence. So far as the evidence shows, all he had to do was to endorse the stock, deliver it to the secretary of the corporation and request that it be transferred on the books of the corporation to John G. Taylor, Inc.

In the Nevada case of Carpenter vs. Clark, 2 Nev. 243, while the Court in that case held the delivery sufficient, it announced the following doctrine construing the Nevada statute above referred to:

> "It seems to us that the reasonable construction to be placed upon the statute is that the change of

> possession must be actual, *bona fide,* and must continue for such a length of time as will under the circumstances of each case, be likely to operate as a general advertisement of the sale or change of title of the property."

In another case, Lawrence v. Brunham, 4 Nev. 361, the Court in concluding its opinion states as follows:

> "Upon the second proposition argued by counsel we only deem it necessary to say that the statute makes the want of delivery 'conclusive evidence of fraud.' No court has the right to say that the want of delivery shall not be so where the creditor has knowledge that a sale has been attempted by the debtor. Whether the attaching creditor knew the fact or not is a matter of no consequence. The law only requires him to show that no delivery accompanied the sale. When that is done his proof is conclusive that the sale was fraudulent as to him, and no evidence of an honest purpose or fair intention upon the part of the vendor or vendee, or the knowledge by the creditor of the fact that a sale had taken place, can overcome the conclusive evidence of fraud which the want of delivery astablishes."

In another Nevada case, Conway vs. Edwards, 6 Nevada 190, the Court, among other things held as follows:

> "Surely, if in this case an immediate delivery had been made (and whether there had or not, was a question upon the evidence in the case for the jury to determine), no better evidence than a continuance of that change could be adduced than proof that the plaintiff assumed the management and control of the property after the sale."

It will be observed in the case at bar that never at any time did the Reno National Bank have possession of the water stock in question. Nobody else but John G. Taylor had possession of it; and he only parted with that possession when he pledged it to the Bank

of Nevada Savings & Trust Co. as security for the corporate loan.

> "The vendee must take actual possession of the property and the possession must be open, unequivocal, substantial and continuous, and must not be taken to be surrendered back. When it appears after the purchase, that the vendee exercised such acts of ownership as is usual for persons who own the same species of property, and that it was at all time after the purchase under his direction and control and was in his charge at the time of the levy and had not been in the possession of either of the vendors, it was held that there was a change of possession."
>
> *Gray vs. Sullivan,* 10 Nev. 416.

A Nevada case very much in point is Comiata v. Kyle, 19 Nevada 38. The Court on page 42 states as follows:

> "Since there was no delivery of the wood and coal, actual or symbolical, should we assume that the legal title to the ranch was in Locatelli nothing less than a conveyance by deed of the real estate, with surrender of possession thereof to plaintiff, would have given the latter possession of the personal property thereon." (Sharon v. Shaw, 2 Nev. 292, Stephenson v. Clark, 20 Vt. 627, Shumway v. Rutter, 8 Pick. 443).
>
> "Plaintiff had neither actual nor constructive possession of any part of the ranch outside of the cabin, or of the wood and coal thereon, at the time of the levy, and that motion for non-suit should have been granted."

In the case at bar, after the execution and recording of the Deed, the corporation, John G. Taylor, Inc., may have had possession of the real property deeded, but it never had possession of the personal property in controversy here, namely the water stock. The corporation, therefore, never had owned the water stock.

And, Again, There Was No Transfer of the Water Stock in Question to John G. Taylor, Inc., to Constitute a Sale or Change of Possession as the Corporation Law of Nevada Provides.

The second paragraph of Section 1617 Nevada Compiled Laws, Volume 1, is as follows:

> "The shares of stock in every corporation shall be personal property and shall be transferable on the books of the corporation, in such manner and under such regulations as may be provided in the by-laws. The delivery of a certificate of stock in a corporation to a bona fide purchaser or pledgee, for value, together with a written transfer of the same, or a written power of attorney to sell, assign and transfer the same, signed by the owner of the certificate, shall be a sufficient delivery to transfer the title against all parties except the corporation. No transfer of stock shall be valid against the corporation until it shall have been registered upon the books of the corporation."

Section 1722 Ibid provides in part as follows:

> "SHARES DEEMED PERSONAL ESTATE—HOW TRANSFERRED.
>
> Sec. 27. Whenever the capital stock of any corporation is divided into shares, and certificates thereof are issued, the stock of the company shall be deemed personal estate. Such shares may be transferred by endorsement and delivery of the certificate thereof, such endorsement being by the signature of the proprietor, or his or her attorney, appointed by written power, or legal representative duly authorized but such transfer shall not be valid against such corporation until the same shall have been so entered upon the books of the corporation as to show the names of the parties by and to whom transferred, the number or designation of the shares, and the date of the transfer, and the old certificate surrendered and cancelled, which must be done in all cases, except in case of loss or destruction of the original, before a new one issue."

It will, therefore, be observed, that not only was there no delivery and change of possession of the water stock in accordance with the express provisions of the fraudulent conveyance statute of Nevada above referred to, but there was an entire absence of observance of the requirements of the Nevada statute as to what constitutes a transfer or sale of corporate stock evidenced by certificates thereof.

The Supreme Court of Nevada in the case of Bercich v. Marye, 9 Nev. 312 determined in a case involving the construction of a California Statute, similar to the one above cited, that,

> "This restriction upon the transfer of stock determines the question of negotiability adversely to appellant."

By this decision the Supreme Court of Nevada recognized the applicability of the statute and held in effect that the statute controlled with respect to the transfer of corporate stock.

And, again, in the case of State of Nevada vs. Leete, 16 Nev. 242, the Supreme Court of Nevada recognized the force of the statute, and on page 250 declared as follows:

> "Under that statute, the whole title passes to the transferee so far as the transferrer is concerned, without an entry upon the books; but, as to everybody else, the legal title remains where it was before the transfer."

> "The mode of transferring shares of stock and the validity and effect of transfers are governed by the laws of the state or country in which the corporation was created, although the transfer may be made in another state or country, and both of the parties may reside there. From the nature of the stock of a corporation, which is created by and under the authority of a state, it is necessarily, like

every attribute of the corporation to be governed by the local law of that state, and not by the local law of any foreign state."

Fletcher's Cyclopedia Corporations,
Vol. 6, Sec. 3777.

"Where the corporate charter, governing statute, or a by-law prescribes the mode in which transfers of stock shall be made in order to be valid as against the corporation and third persons dealing with such stock, such mode must be followed."

14 C. J. 672 Sec. 1042.

"Under the provisions of the statutes of this territory, the certificates of stock in a corporation are personal property, and in order to transfer the legal title to the shares of stock represented by such certificates, they must be transferred by endorsement by the signature of the owner and delivered to the transferee, and, to be good as against third parties, must be transferred upon the books of the corporation."

Haynes v. Brown
89 Pac. 1124
Isbell v. Graybill
76 Pac. 550
Weber v. Bullock
35 Pac. 183 (Citation from 185)

In the following case cited, the Supreme Court of the United States held that the mere assignment of a certificate of stock was inoperative to pass title where the charter of the corporation provides that all transfers should be made on the books of the corporation.

Moores v. Piqua Bank, 111 U. S. 165,
28 Law Ed. 388.

In the following Federal Court case, it was held that the title to registered municipal bonds wasn't complete until transferred on the books of the obligor.

Cronin v. Patrick Co.
89 Fed. 79.

In considering a statute similar to the Nevada Statute, the Supreme Court of New Mexico held as follows:

> "On the part of the defendant in error it is insisted that under the assignment law it is competent for a failing debtor to assign all of his interests, of whatever character, in all classes of property, real, personal, and mixed, and that this transfer is not subject to the statutory requirements which are invoked in this case. We are therefore called upon to determine whether that provision of the statute which declares, "But no transfer shall be valid except between the parties thereto, until the same shall be so entered upon the books of the company," is applicable to the transfer made by an assignor to an assignee. In Wisconsin, under a statute identical with ours, it was held that the language of the statute was inoperative, and that no transfer of stock was valid, except as between the parties unless the transfer was entered upon the books of the company. In re Murphy, 51 Wis. 519, 8 N. W. 419 The same is the doctrine of the California courts. Weston v. Mining Co., 5 Cal. 186; Strout v. Mining Co., 9 Cal. 78; Naglee v. Wharf Co., 20 Cal. 529. Chief Justice Shaw, in the case of Fisher v. Bank, 5 Gray, 373, in passing upon a provision in the charter of the bank to the following effect: "The stock of said bank shall be transferable only, at its banking house and on its books,"—said: "The clause itself is too clear to admit of doubt—'shall be transferable'; that is capable of being transferred. The largest and broadest term to express alienation on the one part, and acquisition on the other. The word 'only' carries an implication, and is as distinct as negative words could make it. There is no other mode. It was not to prescribe one mode, leaving the others unaffected. It made that mode exclusive." The cases of Bank v. Laird, 2 Wheat, 390, and Rock v. Nichols, 3 Allen, 342, are cited as supporting the same proposition. The facts in the case last cited were that Rock, the holder of certain shares in a railroad company, sold them to Nichols, but the conveyance was not recorded in the books of the company, as required

by the statute. Under the conveyance thus made, the same shares were sold under an execution against Rock; and the Supreme Court, speaking by Judge Metcalf, say, "That they could lawfully be so taken admits of no doubt." Fisher v. Bank, 5 Gray, 373. In the case at bar it is admitted that the certificates representing the stock which it was sought to attach were not in possession of the debtor. They had been as already observed, hypothecated. * * * It is enough for the purposes of this case for us to determine—as we do determine —that the assignor having failed to comply with the terms of the statute prescribing the mode, and only mode, by which property of this sort could be conveyed, the assignee took no title, and that therefore the motion to quash the attachment for the reason that the property attached had already been conveyed by assignment was improperly allowed; and for that reason the action of the court below must be reversed."

Lydonbille National Bank v. Fulsom,

38 Pac. 253.

The conclusion is, therefore, that John G. Taylor never having delivered the water stock certificates to John G. Taylor, Inc., the corporation never acquired title to them. Not having acquired title, the corporation could not have mortgaged them to the Reno National Bank.

But in Addition to This, Even the By-Laws of Several of the Corporations Carry Out the Express Provisions of the Statute and Provide for Methods of Transferring Before Title Passes.

The by-laws of the Old Channel Ditch Co. provide as follows:

> "Shares of the corporation may be transferred at any time by the holders thereof, or by their attorney legally constituted, or by their legal representatives, by endorsement on the certificate of stock. But no transfer shall be valid until the surrender of the certificate and the acknowledgement of such transfer on the books of the company."

The by-laws of the Humboldt Lovelock Irrigation Light and Power Co. provide as follows:

> "Transfers of shares shall only be made upon the books of the corporation by the holder in person or by power of attorney duly executed and filed with the Secretary of the corporation, and on the surrender of the certificate or certificates of such shares. Provided, however, the power of attorney above referred to may be endorsed upon the back of the certificate of stock so transferred."

Therefore, concluding this phase of the brief, the following points are noted:

1. The suit is inequitable and unconscionable.

2. There was no sale or transfer of any of the so-called water stock by John G. Taylor to John G. Taylor, Inc., because corporate stock in Nevada is personal property and there was no delivery of any certificates by transfer, endorsement or otherwise. Further, there was no delivery in accordance with the express provisions of certain of the by-laws of the corporations hereinabove mentioned.

3. There was no mortgage of water stock by John G. Taylor, Inc., because the corporation had no stock

to mortgage, because further, the stock being personal property, the necessary affidavits to a chattel mortgage were not included in the real estate mortgage given and because further there was no delivery of the certificates of stock to the Reno National Bank, and, in addition thereto, John G. Taylor treated the stock as his own and pledged it to the Bank of Nevada Savings & Trust Co. as his own, and with the knowledge, authority, approval and consent of the Reno National Bank, appellant's predecessor in interest.

Reply to Appellant's Argument (Brief 11) That the Stock in Controversy Is Appurtenant to the Land and Passed by Conveyance Thereof.

It must be admitted that the Humboldt Lovelock Irrigation Light and Power Co., the Young Ditch Co., the Old Channel Ditch Co., and the Union Canal Ditch Co. are all corporations owning ditch and water rights represented by shares of stock. Whatever rights John G. Taylor had in and to the waters irrigating the lands in question were and are now represented by his stock in these various corporations. When John G. Taylor, Inc., was organized, the only water rights or ditch rights or canal rights or reservoir rights that John G. Taylor could sell or assign or transfer or deliver to John G. Taylor, Inc., were such rights as were represented by his shares of stock in these various corporations.

Whatever may have been the intention of John G. Taylor to have transferred, assigned and delivered his shares of stock to John G. Taylor, Inc., the undisputed, admitted and conceded fact is that he never endorsed the stock, assigned it, transferred it or delivered it. There is no evidence in this case that John G. Taylor, Inc,. through its board of directors or secretary or any

authorized official, ever demanded delivery of the stock. The undisputed evidence is that John G. Taylor, Inc., never held or possessed the stock, that it was never transferred to the corporation, that there never was a request made of the secretary to transfer it to the corporation and that the records of the various water company corporations show the stock to be in the possession and ownership of John G. Taylor. The only person who ever had possession of the water stock, so far as the evidence in this case shows, was John G. Taylor, the original owner, and the Bank of Nevada Savings & Trust Co. to whom it was pledged, and its receiver.

The appellant did not place John G. Taylor on the witness stand to ascertain why he did not deliver the water stock to John G. Taylor, Inc., if he ever so intended. No previous effort had been made by the corporation to force John G. Taylor by way of specific performance to deliver the stock; and the Reno National Bank, after it took its real estate mortgage, never made any effort to secure the stock from John G. Taylor or from John G. Taylor, Inc., but, on the contrary, permitted and definitely authorized the Bank of Nevada Savings & Trust Co. to take it by way of pledge.

It must be observed in the beginning that whatever water covenants went with the land, held, owned and possessed by John G. Taylor personally, were merged in these various companies and held, owned and represented through the shares of stock issued by them. If these shares of stock were never transferred to John G. Taylor, Inc., then this corporation never acquired any water covenants and neither did the Reno National Bank through its real estate mortgage. It must, therefore, necessarily follow, that there is no premise whatever upon which to base the plaintiff's suit, even though

we set aside for the moment the equitable considerations referred to at the beginning of this discussion. It is again insisted that equity alone defeats the suit, but aside from this, if the plaintiff has failed to establish at the very inception that John G. Taylor, Inc., acquired any water covenants running with the land, through a transfer of the stock, then the real estate mortgage and assignment thereof to this plaintiff without such covenants obviously defeats the plaintiff's claim.

The appellant contends that John G. Taylor in his deed to John G. Taylor, Inc., conveyed the shares of stock in question. (Assignment of Error 7—Brief, page 12). The answer to this is, he never did. This seems to be the premise for the plaintiff's suit, but it is a premise not founded upon fact as has heretofore been argued.

It is also contended that the real estate mortgage encumbered all water rights belonging to, incidental to, or appurtenant to, or used in connection with the land. (Assignment of Error 8—Brief, page 12). The answer to this is that all of the water rights were owned and controlled by the various water companies, that there was no transfer of title to any of the stock in these companies, and that, therefore, John G. Taylor, Inc., had no water rights to mortgage. Another answer is that John G. Taylor, Inc., never acquired the water rights represented by the stock. Another answer is, that if this were the original intention, the Reno National Bank certainly waived all claim of lien on the stock by way of mortgage when its board of directors authorized the stock to be pledged for a valuable consideration to the Bank of Nevada Savings & Trust Co.

It is also asserted in the brief that the several ditch companies are not and never have been operated for profit; that because of this, and irrespective of stock

delivery, the stock was a covenant running with the land. The purpose and function of a corporation is not to be ascertained by rumor or report or secondary evidence, but by the corporate charter and the by-laws. There is nothing in the Articles of Incorporation of the Young Ditch Co. to even indicate that the corporation was not to have been operated for profit or was not a corporation organized for profit. In fact, Sections 28 and 29 of the By-Laws provide expressly in what manner dividends may be declared and also provide that there may be set aside, out of the net profits of the company, such sum or sums as the directors may from time to time in their discretion think proper as a reserve fund to meet contingencies or for equalizing dividends. Article V of the By-Laws of the Old Channel Ditch Co. imposes a duty upon the board of directors to declare dividends out of the surplus profits when such profits shall, in the opinion of the directors, warrant the same. Paragraph 28 of the By-Laws of the Union Canal Ditch Co. provides that dividends upon the capital stock of the company when earned shall be payable as the directors shall prescribe. Section 1 of Article IX of the By-Laws of Humboldt-Lovelock Irrigation Light & Power Co. expressly provides for the payment of dividends out of profits. And further, the organization set up and its Articles of Incorporation not only prove its purposes and functions, but aside from engaging in the business of selling water, it also is in the business of selling light and power. An attempt is being made to establish the various water canals and ditch companies as non-profitable mutual corporations for the purpose of applying certain principles of law (hereinafter to be considered) to the corporations in question, but this effort must fail in the face of the corporate set-up of the corporations here involved, since the record firmly establishes them to be

corporations organized, in part at least, for profit and organized generally, and without limitation, under the general corporation law of Nevada.

The fact that money was raised for the operation of some of these corporations through assessing the stockholders, does not at all establish that the corporations were not organized for profit. The test is not as to whether the corporaion was making money so that an assessment would not be necessary, or that it was losing money which required assessment to maintain it, but what were its fundamental purposes and functions as disclosed by its Articles of Incorporation and By-Laws? The fact that all of these corporations were organized under the general corporation law of Nevada and that there was nothing in their corporate set up or by-laws to restrict or limit their operations under the general law, is conclusive proof that they were not joint stock companies or mutual associations not organized for profit. The appellant is endeavoring to maintain the contrary because its only hope to establish a stock water covenant running with the land is to place these corporations in the catagory of non-profit organizations. Here again, the appellant advances an argument in its brief, based upon an erroneous premise.

Furthermore, the evidence in the case shows that the stock in these various corporations was traded in as stock in corporations generally. Much evidence was introduced showing that many of the private stockholdings in several of the corporations were actually pledged for money borrowed from the Federal Land Bank. (Tr. Rec. 123, 126-7, 133-134). In the Union Canal Ditch Company alone, sixteen stockholders pledged their several stockholdings and borrowed money upon the stock. This is significant in not only estab-

lishing that the stockholders treated their holdings normally and in the usual method, but that banking institutions placed a definite value upon the stock as such, accepted it in the due course of business as collateral for loans advanced, and by virtue of the pledges themselves, these banking institutions, upon foreclosure or otherwise, were entitled to hold and possess the stock, even though they held no land or real property whatever in the section of the country involved here or adjacent to or connected with any canals or ditch companies or power companies or irrigation companies or individuals to which any waters or water rights could possibly become appurtenant.

Not only this, but the evidence shows that these Banks, in accepting these pledges had the stock transferred to their respective names as pledgees upon the books of the corporation. This is additional evidence of the fact that the corporations themselves acknowledged the rights of their stockholders to trade in and deal with their stock, independently as they desired. Later, the Federal Land Bank actually foreclosed some of the pledges and became owner in its own right of certain of the stock, and had the stock transferred on the books and re-issued to it. (Tr. Rec. 126). Further, John G. Taylor himself acquired stock in the Union Canal Ditch Co. away back in 1913 AND BEFORE HE WAS A LAND OWNER. (Tr. Rec. 121). Richard Kirman, Mr. Lewis, and Mr. Harris are owners of something like 28,700 shares in the Humboldt Lovelock Irrigation Light & Power Co. which the bank, of which they were officials, accepted in pledge. At the time of the pledge, neither of these individuals, nor the bank, owned any land in that district and only became owners of such land after foreclosure. (Tr. Rec. 126). A Mr. Sullivan acquired 990 shares in this corporation from

one J. H. Henry, and he was not an owner of any land in the particular district when he acquired it. (Tr. Rec. 126). The stock of the Humboldt Lovelock Irrigation Light & Power Co. was traded in and sold from one farmer to another. (Tr. Rec. 126-127). Prince Hawkins acquired 16,553 shares of stock in this corporation after irrigation had ceased; when the corporation was not furnishing any water at all and when his lands were not being irrigated by that system. Stock in the Young Ditch Co. was transferred by the secretary of the company without any inquiry at all as to whether the new owner of the stock was a land owner. (Tr. Rec. 135). Various certificates of stock in the Young Ditch Co. were likewise pledged by stockholders to Nevada Fire Insurance Co. and to Federal Land Bank.

Shares of Stock in These Various Corporations Are Not Appurtenant to the Land.

There is ample authority that water rights may be sold separate and apart from the land, to which it is appurtenant. This principle was followed in the instant matter by transferring all water rights and water rights of way to the various corporations herein referred to. The stockholders in the various corporations own these rights proportionate to the shares of stock held by each.

It must also be conceded that the stockholder had a perfect right to sell, assign, transfer and deliver his stock whether actually for consideration, or pledge it or deal in it as he saw fit. There is nothing in the corporation set up or the by-laws of any of these corporations which limits this right.

> "Unlike ordinary easements the right to the use of water of a stream may be sold and transferred

separate and apart from the land to which it is appurtenant or reserved and excepted from a grant of the land.''

67 C. J. Page 1077, Sec. 553.

''The rights to a supply of water of a stockholder in an irrigation company organized to supply water only to its stockholders, are dependent on, and evidenced by, his shares of stock in the company, and will be lost to such stockholder on his legal transfer of such stock to another and will pass with such transfer of the stock to the transferee thereof, but the transferee cannot acquire greater or different rights to water than his transferor had.''

67 C. J. Page 1399, Sec. 1069.

It is not disputed that a corporation may be organized with limitations and restrictions providing that stock shall only be transferred with land or that corporate stock, as such, is appurtenant to the land, or that it is a covenant running with the land. But that is not the situation here. The evidence is all the other way.

It has also been well established that in the absence of any restriction or limitation in the Articles of Incorporation or the By-Laws, the stock is separate and distinct from the land.

''A corporation may provide that the water-right shall be regarded as attached to the land, and shall pass only with it. In the absence of such provision, however, the stock is separate from the land and an execution sale of the land will not pass the stock.''

Farnum on Waters and Water Rights.

Vol. 3, pages 2001-2002.

There are many authorities in support of this doctrine, some of which being ''on all fours'' with the case at bar.

''While Baun caused the land to be conveyed to his wife and children, he did not convey the stock

nor does it appear that he entered into any contract or received any consideration for the conveyance of the stock. On the contrary, he retained the stock, and continued to act as a stockholder of the company, in his own name. It is true, Baun used the stock as a means of procuring water for the benefit of the land which had been conveyed to his children; but he continued to occupy the land for his own benefit, while he pledged the stock as collateral security, and thereby lost it. With the loss of the stock, he lost all title to the water rights dependent thereon; so that neither he, nor his grantors of the land, can have any water rights by means of such stock. Whether the purchasers of such stock are so situated that they are entitled to receive and apply the water represented by such stock to beneficial use is a question not involved in this litigation. See Combs vs. Ditch Co., supra. Water rights acquired by appropriation in this state, for purposes of irrigation cannot be held to be inseparably annexed to the land in connection with which such rights were acquired. Even though, under certain circumstances, such rights may be considered appurtenant to the land,—a point we do not decide,—they may undoubtedly be severed from the land, and may be sold and conveyed separate and apart therefrom; and where such severance, sale, and conveyance have taken place, as by the assignment and sale of stock representing water rights in an incorporated ditch company, a subsequent sale and conveyance of the land does not pass title to such water rights."

Oppenlander vs. Left-Hand Ditch Co., et al,

31 Pac. 854. (Citation from page 857.)

"As to the extension company, more difficult questions are presented. It is not contended that there was any assignment, delivery, surrender, cancellation or re-issue of the certificate of the extension stock, or that it was transferred upon the books of the company to the trustee. The only thing relied upon is the trust deed hereinabove quoted, by which all other water rights are attempted to be conveyed and the further fact that the extension

ditch had been used to carry water for more than twenty years. It is sufficient to say that, previous to the foreclosure sale Mrs. Marshall's right to carry water of the extension ditch was based upon her ownership of stock in that company. Under the rules of the company, when the ownership of stock ceased, the right to carry water ceased. Plaintiff and its grantors failed to secure that stock,, so that the right can no longer be based upon it. The foundation for its existence having been destroyed, the right itself no longer exists. Mrs. Marshall's right to carry water having been dependent upon her ownership of the stock, and plaintiff failing to secure this, the right cannot be said to have been transferred to it. While there are many cases which hold that a water right or a private ditch may pass with a conveyance of land as appurtenant thereto, yet we know of no case, and counsel has called our attention to none, wherein it is held that a corporation owning a ditch, and furnishing the right to carry water for land to its stockholders only, must continue to carry water for land which has been conveyed to a stranger, while the stock which gave the right remained in the hands of the original owner or had been transferred to other parties."

Oligarchy Ditch Co., et al., vs. Farm Inv. Co.

88 Pac. 443. (Citation from page 444.)

"So far as appears from the proof, each stockholder had the right to use the water to which he was entitled on any land he saw fit. Under such arrangements as are here disclosed by the testimony, the water cannot be regarded as a part of the land, and is not appurtenant to it. The stock of such a corporation is mere personal property, and may be sold and transferred independent of any land; and the sale carries with it the right to use the water on any land or for any purpose the new owner may choose. The stock is merely the evidence of the holder's title to a certain amount of water. That it is personalty is settled in this state by statute. Section 330, Rev. St. 1898. It is not a corporeal, but an incorporeal, species of prop-

erty, and has nothing which gives it the character of realty."

George vs. Robison, et al., 63 Pac. 818
(Citation from page 820)

"The contention of the plaintiffs, and the theory upon which this suit was brought, is that said shares of stock were appurtenant to said lands, and passed with said lands under execution sale. Aside from general well established rules of law which forbid the sanction of said contention, it is directly opposed to the statutory law of this state. Under the provisions of section 4306, Rev. St., "shares which the defendant may have in the stock of any corporation or company" may be attached. Subsection 4, Sec. 4307 Rev. St., is as follows: "Stock or shares or interest in stock or shares, of any corporation or company, must be attached by leaving with the president, or other head of the same, or the secretary, cashier, or other managing agent thereof, a copy of the writ, and a notice stating that the stock or interest of the defendant is attached in pursuance of such writ." By section 4477, Rev. St., "shares and interest in any corporation or company * * * * may be attached on execution in like manner as upon writ of attachment." Under the provisions of these statutes, the procedure is prescribed by which shares of stock and interests in corporations may be seized and subjected to the satisfaction of debts of the execution defendant. The subjection of shares of stock in a corporation to the payment of a debt must, when done by legal process, be done in the manner prescribed by the statutes. The complaint in the case at bar shows that the statutory procedure was not followed. Shares of stock in an irrigation corporation are not appurtenant to the land owned by the owner of such shares, even though such land be irrigated by water from a canal owned by such corporation. The court properly sustained the demurrer."

Wells vs. Price, et al.,
56 Pac. 266.

"The several corporations, in which the said appellant has thus become a stockholder to the extent

above set forth, are corporations organized under the laws of the State of California, and as such are invested with the powers and duties with respect to both the properties thereof and the stockholders therein as the Constitution and statutes of California, and the by-laws of such framed in accordance therewith provide. *They are not, however, such corporations as are referred to in section 324 of the Civil Code, the stock holdings in which have been by the by-laws thereof made appurtenant to certain lands and are to be transferable only with such lands.* The capital stock of the foregoing corporations is transferable in the ordinary manner provided by law, and the owners thereof are the equitable owners of that proportion of the properties of each of such corporations which their respective number of shares of stock thereof bear to the entire subscribed capital stock of the corporation, and as such equitable owners of the properties of the corporation are also equitably entitled to the proportionate distribution of such waters as such corporation acquires by appropriation or otherwise for the various uses for which such waters are acquired. Such stockholders are in that sense and to that extent, but to none other, owners of the water and water rights which the corporation possesses, and over the distribution of which it exercises under general laws and under its particular by-laws full and exclusive control. The term "mutual water company," much stressed by the appellants herein as defining these several corporations, has no defined legal meaning which would serve to differentiate corporations, organized for the acquiring of water rights and the distribution of water, from other corporations owning and administering property for the benefit of their stockholders nor have the stockholders, in that class of corporation, any other or further rights than have those of corporations in general with respect to the administration of the affairs and properties of the corporation."

Consolidated Peoples Ditch Co., et al.
vs Foothill Ditch Co., et al.
269 Pac. 915
(Citation from page 920)

"Since shares of stock in an irrigation corporation, which shares have not been made appurtenant to land are personal property, a deed conveying land, or land and water rights pertaining thereto, will not operate to transfer stock which is not appurtenant to the land conveyed."

67 C. J. 1400.

"The right of a stockholder in a mutual water company to receive water by virtue of his ownership of stock is real property, but the shares themselves are personalty and do not pass upon a conveyance of land unless they are appurtenant thereto; they may become appurtenant by adoption of appropriate provisions in the by-laws of the water company under section 324 of the Civil Code, but one claiming that they are appurtenant is required to prove it."

26 Cal Jur. 449 et seq., and cases in note; also Imperial Water Co. v. Meserve, 62 Cal. App. 593, 217 Pac. 548 and Palo Verde, etc., Co. v. Edwards 82 Cal.

App. 52, 254 Pac. 922.

Wheat vs. Thomas

287 Pac. 102

APPELLANT'S BRIEF FURTHER CONSIDERED

Appellant, in order to avoid the legal effect of corporations organized under general laws, as in the instant case, advances the doctrine that,

> "The case of a corporation is to be determined by what it does and not by what it may do under its articles of incorporation." (Brief App. 29).

In support of this contention, appellant cites two California cases, which, it is respectfully submitted, do not support the doctrine announced. In the case of Southern California Edison Co. v. R. R. Commission, 194 Cal. 757, 763, 230 Pac. 661, a petition for Certiorari to the California Railroad Commission was filed to review and annul an order theretofore made by the Commission. The Railroad Commission had established the corporation as a public utility. The Court was asked to review this finding. The articles of incorporation provided that the corporation might operate as a public utility. The Court found that,

> "There is no merit in this contention. The mere fact that its articles of incorporation empower a corporation to engage in public service does not of itself constitute proof that it is engaged in public service, or that it has dedicated such property as it may own to such service. * * * It may or may not engage in such service, and until it does, it cannot be said to be subject to the jurisdiction of the State Railroad Commission." (Citation from page 664, supra).

It may readily be observed that this case does not establish appellant's contention.

Appellant also cites the case of Del Mar Water Co. v. Eshleman, 167 Cal. 666, 140 Pac. 591, 948. (App. Brief 29). This is a similar case involving a review

of an order made by the Railroad Commission as to whether a corporation was operating as a public utility so as to confer jurisdiction upon the Railroad Commission. The crux of this opinion is stated in the first paragraph of the syllabus as follows:

> "The Railroad Commission has no power to compel a corporation which owns property in private right and has not dedicated it to any public use to apply it to a public use of any kind."

Here again the authority just cited does not support appellant's contention.

Appellant also contends that in this proceeding the appellee receiver should be compelled to turn over the stock to the appellant because Mr. Sheehan, the common vice-president and director and agent of both banks, testified substantially that "at the time the real estate mortgage was being prepared, Mr. Taylor was told that he was expected to give all the security which his company had, and he agreed to do so." (Brief App. 32).

In the first place, it must be observed that Mr. Taylor's company did not have the stock, and that therefore it could not be given as security. In the second place, there is no evidence in the case that the bank ever made a demand upon the corporation for the delivery of the stock. The evidence was conclusive that the bank accepted the real estate mortgage as ample security for the loan, which real estate mortgage made no mention of the stock. (Tr. Rec. 80). The implication is strong that the mortgage security was considered adequate. This implication is further stressed by the undisputed fact that the same bank through its common directorate authorized the stock to be pledged to the Bank of Nevada as security for a loan to the same corporation from that bank. Further, Mr. Taylor, the owner of the stock and who pledged it for the loan,

is not a party to this action. No attempt has been made here to adjudicate his rights as a pledgor, or in any way to affect his equity in the stock. Both he and the two banks treated the stock as belonging to him when he pledged it with the Bank of Nevada Savings & Trust Company. Appellant contends that his equity in that stock should be taken away from him without suit against him, without notice to him, and without demand upon him.

It will be observed that the appellee receiver was not only the receiver of the Bank of Nevada Savings & Trust Company involved here, but of three other additional banks. Appellant contends that,

> "No evidence was introduced respecting the alleged attachment liens of the three State banks for which respondent was receiver, and the only lien claimed by respondent as to which any evidence is shown of record, is that derived through the Bank of Nevada Savings & Trust Company under an alleged pledge agreement from John G. Taylor personally." (Brief App. 34).

The record facts are that the additional three bank receiverships must have been made parties defendant because of knowledge by the plaintiff of these attachment liens. There could be no other reason for making them parties. It is also alleged in plaintiff's complaint (Tr. Rec. 10-11),

> "That said Leo F. Schmidt in his capacity as receiver of Tonopah Banking Corporation, Carson Valley Bank, and Virginia City Bank claims a lien as attaching creditor of John G. Taylor, Inc., and/or John G. Taylor, for an indebtedness in the aggregate principal amount of $24,000.00."

This allegation of the complaint was admitted by the defendant receiver in his answer. (Tr. Rec. 24).

A fact admitted by the pleadings need not be supported by evidence.

Council on page 13 of the Brief state:

> "The District Court rightly concluded that plaintiff, as successor in ownership of the lands described in the complaint, is the owner of all water rights appurtenant thereto, including all rights to all means of transportation and storage of water such as dams, ditches, canals, and reservoirs, from the places or points of diversion to the places or points of use. (Opinion R. 44)."

With this statement, we are in accord. However, there is omitted from the statement a very significant fact. Notwithstanding the well-established principle of water law announced by the trial court, the appellant failed in its brief to observe that under the facts of this case the Court declined to award the stock in controversy to the plaintiff. It is plain to see that the trial Court reached the conclusion that the stock in controversy here did not constitute a water right appurtenant to the lands described in the complaint. The trial Court referred in its opinion to the case of Prosole Steam Boat Canal Company, 37 Nev. 154, 140 Pac. 720, in support of the well-recognized doctrine that the owner of land containing appurtenant water rights is entitled to an easement in ditches, reservoirs, and other irrigation works for the diversion, storage, and conveyance of water from the place of diversion to the point of use upon plaintiff's land. But again, the trial court declined to hold that the plaintiff was entitled to the possession of the certificates of stock. The Court properly held that whatever water had been placed by the plaintiff or its predecessors to a beneficial use upon its lands, it was entitled to have and to have delivered by a canal company on paying the necessary costs and expenses for such delivery; but the Court in so holding

declined to hold that the stock in controversy here should be delivered to the plaintiff.

Counsel on page 35 of the Brief attempt to apply a so-called rule of agency. They assert that, "The knowledge acquired by Sheehan, who was the sole representative of the Nevada Bank in the transaction relied on by respondent, cannot be repudiated merely because Sheehan acquired that knowledge while acting for The Reno National Bank. The knowledge possessed by an agent of two or more corporations is attributable to each irrespective of the capacity in which such knowledge was acquired." This statement leaves out of consideration entirely a very significant fact that Mr. Sheehan, the agent, was acting as a representative of two banking corporations with a common directorate, engaged in the same business, and operating under the same roof. We are making no contention here of a repudiation of Mr. Sheehan's knowledge, but we are urging that when he, as an agent of the Bank of Nevada, accepted the stock certificates in pledge for a loan by that bank, he repudiated and waived all claim he ever had to that stock as a representative and agent of the Reno National Bank. This repudiation and waiver, of course, binds his principal, the bank, for it may not be successfully contended, that the loan having existed for upwards of two years, and the security reposing in the vaults for that length of time, that the bank had no knowledge of it.

BRIEF SUMMARY

It is therefore urged here that the laws of conveyancing and mortgaging preclude a recovery by the appellant. Should the trial court's opinion be reversed despite the common directorate and the application of attendant equitable principles, the appellee bank will not only have parted with its money, but with the security approved and accepted by the predecessor of the appellant. The only possible way that the appellee bank may be made whole and its depositors and creditors protected, is for the appellant to reimburse the appellee bank in the full amount of the loan and accrued interest and take the stock. No such equitable tender has ever been made. In short, the plaintiff, suing in equity, has made no effort to do equity. It is therefore respectfully contended that the opinion of the trial court should be affirmed.

Respectfully submitted,

PLATT & SINAI,
Attorneys for Appellees.

No. 9015

United States Circuit Court of Appeals

For the Ninth Circuit

PACIFIC STATES SAVINGS & LOAN COMPANY, a corporation, substituted for Reconstruction Finance Corporation, a corporation,
Appellant,

vs.

LEO F. SCHMITT, as Receiver of BANK OF NEVADA SAVINGS & TRUST COMPANY, CARSON VALLEY BANK, TONOPAH BANKING CORPORATION and VIRGINIA CITY BANK,
Appellees.

APPELLANT'S REPLY BRIEF

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Pacific States Savings & Loan Company, a corporation, substituted for Reconstruction Finance Corporation, a corporation, *Appellant,*

vs.

Leo F. Schmitt, as Receiver of Bank of Nevada Savings & Trust Company, Carson Valley Bank, Tonopah Banking Corporation and Virginia City Bank, *Appellees.*

APPELLANT'S REPLY BRIEF

PREFATORY STATEMENT

The principal claim of appellant is that the stocks in question were an appurtenance to the lands formerly owned by John G. Taylor and now owned by it, and as such appurtenance passed with a conveyance and mortgage of the lands, without the necessity of any specific description or other formality of transfer.

Secondarily, it is claimed by appellant that the deed in 1930 and the mortgage in 1932, in the light of the circumstances shown by the record, were sufficient to constitute

All emphasis herein is supplied by us.

a conveyance of the water stocks treated as personalty, and that the Bank of Nevada Savings & Trust Company, in whose shoes appellee stands, had actual notice and knowledge of these antecedent transactions, so that, as pledgee, it is in no position to assert a superior claim thereto; and that the other banks for which appellee is receiver, claiming to be mere attaching creditors of one who had, long prior to the attachment, parted with all interest in the stocks, have no rights therein.

Appellee in his brief, contends:

1. That by reason of certain common officers of the Reno National Bank and the Bank of Nevada Savings & Trust Company, he has some superior equity as against appellant.

2. That the deed and mortgage were insufficient to convey or encumber the stock, since it is claimed

(a) The mortgage was not executed with the formalities required by the Nevada law in respect to chattel mortgages;

(b) There was not an open and continuous change of possession of the stock certificates;

(c) The description of the stock was uncertain; and,

(d) The transfer was not in the form of an endorsement on the certificates.

3. That the stock is not appurtenant to the lands.

No exception is taken to the statement of facts contained in our opening brief. The facts are simple and practically undisputed. The companies, whose stock is in controversy, have not and never have had any activity other than the ownership and maintenance of certain facilities for impounding the water of the Humboldt River and transmit-

ting it to the lands of their stockholders. Throughout the corporate history of these companies the lands now owned by appellant have been irrigated by use of the water companies' facilities. The District Court found that all water rights are appurtenant to appellant's lands, and that under Nevada law such water right includes the easement to have water conveyed from the place of diversion to the place of use. Appellee admits (brief, page 45) the correctness of this ruling. The primary question, therefore, is whether the *stock* of these companies, representing in fact nothing more than the right to the use of their facilities, is itself an appurtenance of the lands. Appellee admits that the stock in question represents the water rights (brief, page 30). Since the water right necessarily can exist only as an appurtenance to land, the stock which represents the right must also be an appurtenance. If this be so, it completely disposes of the case, as there is no question of appellant's title to the lands and any appurtenances which could have passed by a deed of the lands.

THE STOCK IS AN APPURTENANCE

All of appellee's arguments respecting the irregularity in the mode of transfer or encumbrance of the water stocks may be wholly disregarded if the stocks constitute appurtenances to the lands so as to pass with the conveyance of it. A similar situation was considered in *San Gabriel Valley Bank v. Lakeview, etc. Co.,* 4 Cal. App. 630, 633, where the court said:

> "Appellant McNutt makes the point that the mortgage of the water stock is ineffectual as to him, arguing that it is personal property and not of the list subject to be mortgaged under the statute, and is not

> mortgaged with the formalities required * * * and though it may be good as between the parties, it is not operative as against him without an averment of notice or knowledge on his part which is not contained in the complaint. The point appears to us to be without merit for two reasons: (a) the stock is declared by the mortgage to be a water right appurtenant to the land. Anything appurtenant to the land passes with it***."

In other words, the mode of transfer of the stock is entirely immaterial if the stock was an appurtenance to the land, since, in that event, a conveyance of the lands (admittedly made) would without more pass the stock as such appurtenance.

Appellee also concedes that the stocks here in question represented the water rights appurtenant to the Taylor lands. At page 30 of his brief, he says:

> "It must be observed in the beginning that whatever water covenants went with the land held, owned and possessed by John G. Taylor personally, were merged in these various companies and held, owned and *represented* through the shares of stock issued by them."

At page 45 of his brief, appellee concedes that the district court rightly concluded that appellant is the owner of the water rights appurtenant to the lands. Under the law of Nevada, as construed by the Supreme Court of that state in *Prosole v. Steamboat Canal Co.*, 37 Nev. 154, 140 Pac. 720, water rights are inseverable from the land. They can exist only *as an appurtenance to land.*

In the *Prosole* case, the Supreme Court of Nevada said (140 Pac. at p. 722):

> "* * * a water right for agricultural purposes, to be available and effective, *must be attached to the land*

> and become in a sense appurtenant thereto by actual application,"

and also that (140 Pac. at pages 723, 724):

> "* * * the very right itself, relating as it does to the land upon which it is applied, although in a sense incorporeal, nevertheless, by reason of its application, becomes *an integral part of the freehold.* The water and the land to which it is applied become so interrelated and dependent on each other in order to constitute a valid appropriation that the former *becomes by reason of necessity appurtenant to the latter.*"

If, as appellee concedes, the stocks in controversy represented the water rights, the stocks are appurtenant to the land since the right they evidence can exist only as an appurtenance to land. This would seem to dispose of the case.

In other jurisdictions, water rights may be severed from land and be transferred apart from the land. It is in such jurisdictions that the cases arose upon which appellee relies in his claim that the stock is not appurtenant. Whatever might be the case if severance were possible in Nevada, the fact is that here there was no severance nor attempt to sever the water rights from the Taylor lands, and the District Court properly found that from the beginning the water rights, and the easement to use the facilities of the water companies in enjoyment of that right, were always appurtenant to the lands now owned by appellant. The adjudication of water rights by the state court (Ex. 10, R. 101) and the certificates of appropriation (Ex. 11 and 12, R. 107-112) both show that the water rights which appellee says were represented by the stock, exist solely as appurtenances of the lands where used. The findings of fact (R. 55) are in accord. Such being the case, it is

unnecessary to consider texts or cases which treat of a situation where the water right has been severed from the land.

Of the eight cases cited by appellee in support of his contention, four of them (*Consolidated Peoples Ditch Co. et al. v. Foothill Ditch Co.*, 205 Cal. 54; 269 Pac. 915; *Imperial Water Co. v. Meserve,* 62 Cal. App. 593, 217 Pac. 548; *Palo Verde, etc. Co. v. Edward*, 82 Cal. App. 252, 254 Pac. 922; and *Wheat v. Thomas*, 209 Cal. 306, 287 Pac. 102) are California cases, decided after the adoption of the 1895 amendment to Section 324 of the California Civil Code (now Section 330.24), prescribing certain formalities which must be complied with in order to make stock appurtenant to land. They are all founded upon a statute, no counterpart of which is to be found in Nevada. Prior to the adoption of the amendment, as held in *In re Thomas' Estate,* 147 Cal. 236, the law of California was the same as the law of Montana, Idaho and Utah, as declared by the Supreme Courts of those states in *Yellowstone Valley Company v. Association Mortgage Investors,* 88 Mont. 73, 290 Pac. 255, and the other cases cited in appellant's opening brief.

Of the four remaining cases, two (*Oppenlander v. Left-Hand Ditch Co.*, 18 Colo. 142, 31 Pac. 854, and *Oligarchy Ditch Co. v. Farm Inv. Co.*, 40 Colo. 291, 88 Pac. 443) are decisions of the Supreme Court of Colorado, which, as pointed out in *Yellowstone Valley Company v. Associated Mortgage Investors*, 88 Mont. 73, 290 Pac. 255, are at variance with the rule adopted in all other Western states. But even the Colorado courts do not go to the extent of holding stock in water companies to be not appurtenant to the land where the articles of incorporation contain provisions similar to those contained in the articles of the Humboldt-Love-

lock Irrigation Light & Power Company (Record, p. 85), as is demonstrated by the recent decision of the Supreme Court of Colorado in *James v. Barker*, 99 Colo. 551, 64 Pac. (2) 598.

Of the two remaining cases cited by appellee, the Utah case (*George v. Robinson, et al.*, (Utah) 63 Pac. 819) was distinguished from cases such as this in *In re Johnson's Estate,* 64 Utah 114, 228 Pac. 748, and the Idaho case (*Wells v. Price,* 6 Idaho 490, 56 Pac. 266) is directly contrary to the later decision of the Supreme Court of Idaho in *Ireton v. Idaho Irrigation District,* 30 Idaho 310, 164 Pac. 687.

Even if the cases cited by appellee were authority for the proposition that ordinarily stock in a ditch and reservoir company is not appurtenant to the land, they would have no application to the present case, where the water rights have never been severed from the land and are vested in the landowners and not in the corporations.

Since the only beneficial rights represented by the stock are rights to the use of the facilities of the respective corporations for the diversion and conveyance of water, and since these rights, as found, declared and adjudged by the court below, in its opinion (Record, p. 41), findings and decree, are appurtenant to the land upon which the water has been applied to a beneficial use, it necessarily follows that the stock itself is appurtenant. In the hands of one other than the appellant, the stock "has no value actual or potential except for nuisance purposes," *Twin Falls L. & W. Co. v. Twin Falls Canal Co.*, 7 Fed. Supp. 238 at page 246 (affirmed C.C.A. 9, 79 Fed. (2), 431, Cert. denied, 80 L. ed. 466).

APPELLEE HAS NO EQUITY SUPERIOR TO APPELLANT

Appellee argues that inasmuch as The Reno National Bank and the banks of which appellee is receiver had common officers and directors, the appellee should be adjudged to have the paramount right to the stock regardless of all other considerations. This argument is based on the principle that transactions between banks or corporations having common directors are viewed with suspicion and will not be sustained unless entirely fair to both corporations. This principle can have no room for application in the case at bar. No contract or transaction between The Reno National Bank and The Bank of Nevada Savings & Trust Company is sought to be set aside or rescinded or enforced. As a matter of fact, the record fails to disclose any contract, transaction or dealing between the two banks, of any nature whatsoever, regarding the subject matter of this suit. There is, therefore, nothing upon which the principle relied upon by the appellee can operate.

Aside from this, however, the record shows no breach of trust or duty on the part of the officers of the two banks with which appellant can be charged. When, on April 23, 1932, The Reno National Bank assigned the Taylor mortgages to the Reconstruction Finance Corporation, neither that bank nor its officers committed any breach of duty or trust toward the Bank of Nevada Savings & Trust Company. When, a month later, the Bank of Nevada Savings & Trust Company made its advances to John G. Taylor, Inc., the officers of that bank may or may not have been guilty of having committed a breach of trust or duty; but if they were, neither the Reconstruction Finance Corporation nor its successor, the appellant, could be prejudiced by it, since neither had any knowledge that the advances were made, nor did either participate in or sanction the making there-

of. Nor did either have any knowledge of, or any active or tacit participation in, the alleged pledge of the stock to the Bank of Nevada Savings & Trust Company.

If appellee's argument were carried to its logical conclusion, it would follow as a necessary consequence that if a corporation sells property to a third party and subsequently sells the same property to an affiliated company, the latter, from the mere fact alone that it has the same officers and directors, would obtain a better title than the third party.

The fallacy of appellee's argument lies in the failure to distinguish between the Reconstruction Finance Corporation and its successor in interest, the appellant, on the one hand, and The Reno National Bank, the assignor of the Reconstruction Finance Corporation, on the other. An assignee takes subject to equities and defenses existing at the time of the assignment, but once the assignment has been made nothing assignor may do can in any manner impair the title of the assignee. True, a subsequent assignee may, under certain circumstances, be entitled to priority over a prior assignee, but, as pointed out in *Salem Trust Co. v. Manufacturers Finance Co.*, 264 U. S. 182, 197, 198; 68 L. ed. 628, 635, this results, in the absence of statute, only where by some act or omission of his own the prior assignee has estopped himself from asserting priority over the later assignee. In the case at bar, as appellee concedes, the Bank of Nevada Savings & Trust Company made the advances and obtained possession of the stock certificates with full knowledge of the fact that the stock had previously been hypothecated to the Reconstruction Finance Corporation. The advances were made and possession of the stock certificates was obtained by the Bank of Nevada Savings & Trust Company without knowledge or consent of the Re-

construction Finance Corporation, and there is nothing in the record to show that any act or omission on the part of the Reconstruction Finance Corporation misled the Bank of Nevada Savings & Trust Company in any manner.

THE TRANSFER AND MORTGAGE OF THE STOCKS WAS VALID AS AGAINST APPELLEE

Even though the stocks were not appurtenant to the lands, the 1930 deed and the 1932 mortgage were effective to convey and encumber the same as between the parties and as against the world except a bona fide purchaser or encumbrancer for value.

The objections urged by appellee to the mode of transfer can not be availed of by him since he is not such a bona fide purchaser or encumbrancer. As receiver, appellee stands in the shoes of the banks for which he is acting in that capacity. The Bank of Nevada Savings & Trust Company, as pledgee, admittedly had actual knowledge of the antecedent transactions, and is not a bona fide purchaser or encumbrancer. The other banks for which appellee is acting, are mere attaching creditors, whose rights accrued long after the party whose rights they sought to attach, had parted with all interest in the property.

All of the contentions advanced by appellee as to the irregularity in the mode of transfer depend entirely on the question whether appellee is a bona fide purchaser.

We will, therefore, first discuss that question, and then the several contentions advanced by appellee respecting the mode of transfer.

Appellee concedes that the Bank of Nevada Savings & Trust Company had full actual knowledge of the mortgage and its assignment to appellant's predecessor in interest,

but seeks to escape the effect of that knowledge on the ground that The Reno National Bank and the Bank of Nevada Savings & Trust Company had the same officers and directors. Thus, on page 16 of his brief, appellee says:

> "Certainly the Bank of Nevada Savings & Trust Company as a creditor had notice of the mortgage, but this notice was had through the common directorate of both banks."

Again, on page 46 of his brief, appellee says:

> "We are making no contention here of a repudiation of Mr. Sheehan's knowledge, but we are urging that when he, as an agent of the Bank of Nevada, accepted the stock certificates in pledge for a loan by that bank, he repudiated and waived all claim he ever had to that stock as a representative and agent of the Reno National Bank."

Appellee cannot escape the effect of the actual knowledge of the officer of the Bank of Nevada Savings & Trust Company on the ground that that Bank and The Reno National Bank had the same officers and directors. The fact remains that they were the sole representatives of the Bank of Nevada Savings & Trust Company. Being the sole representatives, there was no one from whom they could have concealed or communicated the information. Such being the case, the Bank of Nevada Savings & Trust Company stands charged with their knowledge.

> "If Cornish was the sole representative of the bank in the transaction with himself, there was no one from whom information could have been concealed or to whom it could have been communicated. If he was the sole representative of each party, each must have had equal knowledge. As the representative of the bank, his knowledge was not affected by his private interests, however

much his conduct may have been. He necessarily knew as much in one capacity as he did in the other. The bank is charged with the knowledge which Cornish had."

First National Bank v. Blake, 60 Fed. 78, 79.

See also *National Bank of San Mateo v. Whitney,* 40 Cal. App. 276, 283; 180 Pac. 845; 2 Am. Jur., 300.

Independently of this rule, there is another reason why appellee cannot escape the effect of the actual knowledge of the officers of the Bank of Nevada Savings & Trust Company. The Reconstruction Finance Corporation, appellant's predecessor in interest, did not authorize or participate in the making of the advances and actually had no knowledge of the fact that they were made until long afterwards. In these circumstances, the appellee cannot escape the effect of the knowledge of the Bank's officers by charging that in making the advances they were acting adversely to the Bank of Nevada Savings & Trust Company.

> "The fact that those agents committed a fraud cannot alter the legal effect of their acts or of their knowledge with respect to the company in regard to third parties who had no connection whatever with them in relation to the perpetration of the fraud and no knowledge that any such fraud had been perpetrated. There is no pretense of any evidence that the defendants had any connection with these alleged frauds and no pretense that they had any knowledge of their existence if they did exist. *In such case the rule imputing knowledge to the company by reason of the knowledge of its agent remains.*"

Armstrong v. Ashley, 204 U. S. 272, 283, 51 L. ed. 482, 487.

Appellee as receiver of the Bank of Nevada Savings & Trust Company is not, therefore, an innocent purchaser,

and is in no position to attack the mortgage under which appellant claims. A receiver, as stated by appellee, stands in no better position than the bank or corporation which he represents.

Organ v. Winnemucca State Bank & Trust Co., 55 Nev. 72, 26 Pac.(2) 237, 238.

As receiver of the banks other than the Bank of Nevada Savings & Trust Company, appellee is a mere attaching creditor, not of John G. Taylor, Inc., but of John G. Taylor, individually. As such, he is obviously not an innocent purchaser for value.

> "It cannot be successfully maintained that an attaching creditor stands in the position of a bona fide purchaser for value. He has in fact parted with nothing of value, but has merely instituted an action in which he utilizes the provisional remedy of attachment for the purpose of rendering more secure the judgment which he hopes to obtain. (4) An attachment lien attaches only to the debtor's interest in the property at the time of its levy (3 Cal. Jur., p. 483; *National Bank v. Western Pac. Ry. Co.,* 157 Cal. 573, 576, (21 Ann. Cas. 1391, 27 L.R.A. (N.S.) 987, 108 Pac. 676).) In *National Bank v. Western Pac. Ry. Co.,* supra, it was held that the purchaser for value of stock in a corporation, which was not transferred on the books of the corporation at the time of an attachment levy in a suit brought by a creditor of the seller, may compel a transfer upon the books of the corporation and the issuance of a certificate for the stock free from the attachment lien."

Ahern v. Tulare Lake Canal Co., 115 Cal. App. 93, 101, (2) 490.

In view of the foregoing, we respectfully submit that under no circumstances can the appellee be said to be an

innocent purchaser or encumbrancer without notice. With this foreword we may proceed to consider appellee's arguments. In order to permit of a more orderly consideration of the subject, the four arguments or contentions urged by the appellee will be discussed in a slightly different order than that in which they are advanced in appellee's brief.

The Transfer of the Stock by Taylor to John G. Taylor, Inc., Was Not Void Under Sections 1617 and 1722 N.C.L. 1929 or the By-Laws of the Respective Companies

Appellee argues that the transfer of the stock by the deed executed and delivered by John G. Taylor to John G. Taylor, Inc. in 1930 (Appellant's Ex. 1) was ineffectual to pass title to the shares as against the appellee as a subsequent pledgee and creditor of John G. Taylor, because of the provisions of Sections 1617 and 1722 N.C.L. 1929. The two sections are substantially identical. Section 1617 applies only to corporations organized under the Corporation Law of 1925, and since none of the corporations involved in this action was organized under that act, no further consideration need be given to it.

Section 1722 can afford appellee no help, for contrary to appellee's contention, the section does not restrict the manner in which shares of stock may be transferred. It merely prescribes a mode by which transfers of shares may be made and does not prohibit a transfer by other methods nor declare that when made in another manner a transfer may not be enforced by the party entitled to the shares. Thus, in *Young v. New Pedrara Onyx Co.*, 48 Cal. App. 1, 192 Pac. 55, the court, in construing a similar California statute, said:

> "A share of stock being an incorporeal right, incapable of manual delivery, and the certificate being

nothing more than evidence of its existence, it is obvious that, in the absence of any controlling statutory inhibition, the shares, without an assignment or delivery of the certificate, may be assigned in any manner appropriate to the transfer of incorporeal personal property, as, for example, by a bill of sale, or any mode that will suffice to pass title to a chose in action or intangible property. The *jus disponendi* in shares of stock is an incident of ownership, and may be exercised in any manner not prohibited by law. (*Lipscomb v. Condon,* 56 W. Va. 416, (107 Am. St. Rep. 938, 67 L.R.A. 670, 49 S.E. 392).

"* * * we are satisfied that even where, as here, certificates have been issued, a transfer of title, good as between the parties thereto, may be made in manner other than that recognized as a lawful mode of transfer by Section 324; that a transfer of title, good as between the parties, may be made in any manner appropriate to the assignment of choses in action or intangible personal property, * * *"

A transfer valid as between the parties is of course valid as against all the world, excepting only innocent purchasers and encumbrancers for value. Thus in construing a statute which in express terms provided that unregistered transfers of stock should not be valid "except between the parties," the California courts have uniformly held that such transfers of stock "are nevertheless valid as against all the world except subsequent purchasers in good faith without notice."

National Bank v. Western Pac. Ry. Co., 157 Cal. 573, 108 Pac. 676;
People v. Elmore, 35 Cal. 653;
Spreckels v. Nevada Bank, 113 Cal. 272, 45 Pac. 329.

Neither the Transfer of Stock to John G. Taylor, Inc., Nor the Mortgage Thereof to the Reno National Bank Was Void Under Sec. 1536 N.C.L. 1929

Corporate stocks are incorporeal property incapable of possession.

Jean v. Jean, 207 Cal. 115, 120, 277 Pac. 313;
Payne v. Elliott, 54 Cal. 339;
Vidal v. South Amer. Securities Co., 276 Fed. 855, 868.

Notwithstanding this, appellee contends that the transfer of the water stock to John G. Taylor and the mortgage thereof was void under the provisions of Section 1536, N.C.L. 1929, which provides that a sale of "goods and chattels" is void as to creditors of the seller and subsequent purchasers in good faith, unless there be an immediate and continued change of possession.

It is impossible to conceive how this section can be made to apply to things which by their very nature are incorporeal, incapable of possession and not susceptible of manual delivery. Not only is this so, but it has been affirmatively held that similar statutes do not apply to stocks and bonds (*Westinghouse Electric & Mfg. Co. v. Brooklyn R. T. Co.*, 288 Fed. 221, 239).

The fallacy of appellee's argument to the contrary results from the failure to distinguish between certificates for corporate stock and the stock itself. The two are not the same.

A stock certificate is evidence of the title to stock and is not the stock itself, nor is it necessary to the existence of the stock.

National Bank v. Watsontown Bank, 105 U. S. 217, 222, 26 L. Ed. 1039;

The statute requires an actual and continued change of possession of "the things sold or assigned." It does not require a change of possession of the muniments of title of the things sold or assigned.

It is submitted, therefore, that appellee's contention that the transfer of the stock to and hypothecation thereof by John G. Taylor, Inc. was void under Section 1536, N.C.L. 1929, is without merit. A statute requiring a change of possession cannot be applied to a thing which from its very nature is incapable of physical possession.

The Mortgage Was Not Void Under Section 987, N.C.L. 1929

For much the same reason, appellee's argument that the mortgage under which appellant claims was void under Section 987, N.C.L. 1929, not valid. The section mentioned provides that a chattel mortgage is void as against creditors of the mortgagor and subsequent purchasers and by encumbrancers of the mortgaged property unless affidavits of good faith are appended thereto.

This statute is substantially identical to similar statutes adopted in almost every state of the union. Such statutes uniformly have been construed as inapplicable to mortgages of intangibles such as corporate stock. In *Jones on Chattel Mortgages,* 5th ed., sec. 278, it is said:

> "*Choses in Action.*—Statutes respecting the recording of mortgages of personal property apply only to goods and chattels capable of delivery, and not to defeasible or conditional assignments of choses in action. It is not necessary to the validity of such assignments that they be recorded. The capital stock of a corporation is not goods and chattels within the meaning of the act concerning chattel mortgages, and therefore a

mortgage of such stock need not be filed or recorded, and the record of it is of no effect."

See also: *Williams v. New Jersey S. R. Co.*, 26 N. J. Eq. 398, 403; *Westinghouse, etc. Co. v. Brooklyn R. T. Co.*, 288 Fed. 221, 229.

Considering the purpose and background of the statute, there is no reason why the Nevada Statute should be construed differently from its counterparts in other states. It was intended to apply and in fact does apply only to mortgages of tangible personal property and not to mortgages or defeasible assignments of choses in action or other intangibles. It has, therefore, no application whatsoever to the case at bar.

Moreover, appellee is not a subsequent purchaser or encumbrancer in good faith, notwithstanding the fact that the stock is described in the pledge agreement executed by John G. Taylor to the Bank of Nevada Savings & Trust Company. The uncontradicted testimony of appellee's own witness shows conclusively, and appellee in his brief admits, that at the time the Bank of Nevada Savings & Trust Company made the advances it had full knowledge of the fact that the stock had been hypothecated to the Reconstruction Finance Corporation. As hereinbefore shown, appellee is chargeable with that knowledge.

The Mortgage Is Not Void for Indefiniteness

Appellee urges that even if the mortgage is sufficient to create a valid lien upon the stock, as between the parties to it, it is not sufficiently definite to create a valid lien on the stock as against third parties. No consideration need be given to this contention for the reason that as herein-

before shown, the Bank of Nevada Savings & Trust Company had full knowledge of the hypothecation of the stock to the appellant's predecessor in interest, the Reconstruction Finance Corporation. In such circumstances, appellee is not in any position to assert that the description contained in the mortgage is insufficient to create a valid lien on the stock:

> "Insufficiency or inadequacy of description in a chattel mortgage is an attack open to creditors, incumbrancers, and purchasers in good faith, whom it is sought to affect by reason of the constructive notice attaching to the recording or filing of the mortgage; but, inasmuch as actual notice is of a higher character than constructive notice, one who has actual knowledge of the existence of the mortgage and of the property affected thereby cannot avail himself of any lack of sufficiency of description as could one to whom constructive notice alone was attributable. The creditor with actual knowledge of all the facts does not rely upon the public records to give him constructive notice of that which he already knows."

Fenby v. Hunt, 53 Wash. 127, 101 Pac. 492, 493.

As receiver of the banks other than the Bank of Nevada Savings & Trust Company, appellee is a mere attaching creditor of John G. Taylor. Whatever interest Taylor had in the stock passed to John G. Taylor, Inc. in 1930, long prior to the time appellee levied his attachment. As an attaching creditor, therefore, appellee has no lien on the stock and is not in a position to attack the sufficiency of the mortgage.

Stowe v. Harvey, 241 U. S. 199, 60 L. ed. 199, 36 Sup. Ct. 541.

None of the four legal defenses urged by the appellee, although plausibly advanced, is well founded, even if the stock is not appurtenant to the land. If the stock is appurtenant to the land, then, as we pointed out at the outset of our discussion, all of the legal defenses advanced by the appellee are wholly irrelevant and immaterial, for the reason that whatever is appurtenant to the land will pass with the conveyance of it.

The decree should be reversed, with instructions to enter a decree adjudging appellant to be the owner of the stocks described in the complaint, free from any claim of appellee, and directing the surrender of the certificates for such stocks to appellant.

Respectfully submitted,

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No. 9015

IN THE

United States Circuit Court of Appeals

FOR THE

Ninth Circuit

PACIFIC STATES SAVINGS & LOAN COMPANY, a Corporation, Substituted for Reconstruction Finance Corporation, *Appellant,*

vs.

LEO F. SCHMITT, As Receiver of Bank of Nevada Savings & Trust Company, Carson Valley Bank, Tonopah Banking Corporation, and Virginia City Bank, *Appellees.*

PETITION FOR RE-HEARING

FILED

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PETITION FOR RE-HEARING

NOW COME the above-named appellees and respectfully petition the above-entitled court for re-hearing herein

upon the following grounds and for the following reasons:

1.

The Court, In Its Opinion, Did Not Pass Upon Appellees' Point, Raised In the Brief, That the Suit Is Inequitable and Unconscionable

This contention was urged in appellees' pleading in the trial court, was advanced upon the trial, and orally argued upon appeal. May we presume further to clarify the point as follows:

The common directorate managed both banks. As such, it owed an equal duty to the depositors of both banks. This obligation carried with it a requirement that good and sufficient security be demanded for money loaned out of either or both banks. The responsibility for the sufficiency of this security rested with the common directorate. The definite acceptance of security for depositors' money loaned from either bank was notice to the depositors that by duty, morals, and law, the common directorate was conscientiously attempting to protect their deposits. The depositors were justified in feeling secure that after their money had passed to a borrower, the common directorate could not later repudiate the security and leave them without protection. If these assertions be convincingly correct, then this suit by the successors of a common directorate, not only to repudiate the security, but to pass it over for the benefit of the other bank over which

it had equal supervision, is a glaring example of unfairness, double-dealing, duplicity, and implied fraud.

Here, the common directorate approved two mortgages as good and sufficient security for a $700,000 loan from the Reno National Bank. They must be assumed to have known what the mortgages provided and what property they encumbered. With this knowledge, THEY MUST HAVE CONCLUDED THAT THE STOCK IN QUESTION HERE WAS NOT PLEDGED BY EITHER MORTGAGE, FOR THEY ACCEPTED THE STOCK AS GOOD COLLATERAL FOR THE LOAN FROM THE OTHER BANK. Their every official action in handling both loans proves this. Never once, while the banks were open, so far as the record discloses, was the validity of this stock security for the Bank of Nevada loan ever questioned or assailed. With knowledge of the common directorate, it passed every directors' meeting of both banks and every Federal and State bank examiner. After the depositors' money was handed over the counter, the stock-collateral was in no other place but in the vaults of the Bank of Nevada. The common directorate always treated and considered it as pledged to this bank. Their authorized Vice-President and General Manager of the Reno National Bank, Jerry Sheean, personally witnessed the endorsed signature of Taylor, by which the stock-collateral was deposited with the Bank of Nevada. It was approved and accepted by him, and he even endorsed upon the notes the purpose

for which the money loaned was to be used. Never once, so far as the record shows and while the banks were open, did the Reno National ever make a demand upon the Bank of Nevada for this stock. Never once during this time, was it ever hinted or suggested that the stock was included in these mortgages. It has been carried continuously up to this very day on the books of the Bank of Nevada as an asset of that bank, AND WITH THE VERY CONSENT AND APPROVAL OF THE RENO NATIONAL, PREDECESSOR TO THIS APPELLANT. Is it not certain in law, equity, and business morals, that an assignee or substituted plaintiff, in a case like this, is bound by the acts of his predecessor in interest? If the Reno National, tacitly, openly, and undoubtedly waived any claim to this stock and lulled depositors into a sense of security, may the R. F. C. or the present appellant come along, take the security away, and leave the depositors holding an empty sack? Is it possible that he who seeks equity need not do equity, and innocent depositors, who have no redress here at all, may, in equity, have valuable assets taken away from them without being reimbursed by a single dollar? Does it restore equity and protect the depositors by adopting appellant's contention that the assignee, the Reconstruction Finance Corporation, knew nothing about any water-stock when they loaned money to the Reno National and overlooked interpreting their collateral until long after both banks were closed? It was their duty to examine and construe their collateral

and investigate the facts. If they were guilty of any dereliction, should these depositors be compelled in equity to make good their mistake, and without compensation, part with valuable assets? And if it was the duty of the Reno National to explain to the R. F. C. that the stock was pledged to the Bank of Nevada by the very direction and order of the Reno National, that money was loaned on it, that it was held by the Bank of Nevada, that the Reno National considered it outside and not a part of the Taylor mortgages, and the Reno National failed to perform that duty, who is responsible, the Reno National, or innocent depositors in the Bank of Nevada? Should they have sued themselves or the depositors? Or should the R. F. C. have sued the Reno National for concealing material facts with respect to securities? It seems revolting to all principles of equity that this suit should be maintained against the Receiver of the Bank of Nevada, whose duty it is to protect his depositors.

The same reasoning, of course, applies to the substituted plaintiff, the appellant herein, who is bound by predecessor acts. While the appellant becomes a substituted party through purchase by mortgage foreclosure, the court must not be misled by the belief that the purchase definitely includes the stock in controversy here. Counsel have stipulated that the status of this stock is to abide the final determination of this case. (Tr. Rec., 132-133.)

There is some irony in further contemplation of the

equities involved, which was suggested in the brief and oral argument. Taylor, Inc., gave the Reno National a chattel mortgage encumbering "certain described livestock, machinery, tools, and merchandise upon the lands described in said real property mortgage." (Tr. Rec., 81.) When the same corporation applied for the additional loan from the Bank of Nevada, Mr. Sheean, authorized representative of both banks, endorsed his initials "J. S." on the notes. In addition, he endorsed on one note "taxes and wages," and on another note "shearing." He testified that the loan was made "because it was necessary to furnish Mr. Taylor with some expense money." He also testified that the word "shearing" was in his handwriting and testified "that the request for money was for that purpose." (Tr. Rec., 15-146.) "Expense money" for what? Whose sheep were going to be "sheared"? "Taxes and wages" for what? The answer is plain. The money so borrowed from the Bank of Nevada was to be used to protect the property mortgaged to the Reno National Bank. The corporation owned no other property. Therefore, the money MUST have been used to protect this very property. Taxes due on the real property mortgaged, perhaps some on the personal property mortgaged! Wages to pay employees for taking care of the real and personal property and for shearing the sheep, likewise mortgaged! By this loan, the Reno National Bank was relieved from advancing thirty-two thousand five hundred dollars expense money, and the mortgages assigned to the R. F. C. had that much greater

net value as collateral. Though both the Reno National and the R. F. C. accepted the benefits of this large amount of money for the protection of their own securities, they not only do not make a tender of the money in return, but they bring suit to take away all the collateral besides, and put it in their own coffers for their further exclusive use and benefit.

Therefore, a summary of the point briefly stated is, that the directors here are in fact suing themselves in equity to take away security, which they solemnly and advisedly accepted for one bank, to give it to another bank for the benefit of the latter and to the detriment of the former. As stated in our brief, according to high authority, this is implied fraud. It is believed that this court has the power and authority to order such a suit dismissed, either on its own motion, or by suggestion, if the evidence and the record undeniably disclose a state of facts such as are conceded here.

2.

The Court, In Its Opinion, Did Not Consider the Point Raised In Appellees' Brief, That the Rule of Knowledge or Notice Does Not Apply Here

In a foot-note on page 3 of the opinion, the court states, "It is conceded that the pledgee bank had actual knowledge of the prior mortgages to the Reno National Bank." It is assumed that the fact of notice had some bearing upon

the ultimate conclusion reached by the court. While the statement in the foot-note is literally correct, it takes out of consideration the fact, as we argued in the brief, that knowledge was acquired because the directorate was the same for both banks. It is not the case of a separately managed corporation accepting security with the knowledge that it was pledged to another. The statement of the court followed the contention of appellant, which, it must be observed, disregarded the very important admitted fact of the common directorate. We again respectfully stress the point that the very knowledge of the directors, as to the mortgages referred to, only adds emphasis to our contention that in the face of this knowledge, they approved the stock-collateral for the other bank and waived all right to claim it as pledged to the former bank. They were estopped from denying the validity of a pledge which they had solemnly declared was good and valid, and upon which they loaned a large sum of money.

3.

The Court Inadvertently Disregards Another Important Conceded Fact

It is established, without contradiction, that the corporations, whose shares of stock are in controversy here, OWN NO IRRIGATED LANDS WHATEVER. As the opinion of the trial court discloses (Tr. Rec., pp. 41-42), "None of the corporations, the stock of which is here involved, appears to be the owner of irrigated lands. Such

stock, therefore, does not present any element of interest in rights to water as such; particularly is this the case of the several ditch companies."

It is believed that it is accurate to state that in Nevada, in order to apply the doctrine of appurtenant water, there must first be established some form of title or interest in land, and second, there must be established a given amount of water put to a beneficial use upon the land. Both of these elements are lacking insofar as the certificates of stock here involved may be concerned. The ditch companies own neither water nor land. The Humboldt-Lovelock Irrigation, Light & Power Company owns a reservoir in which are stored flood waters, and which waters are sold to anybody who will pay the price, but Class A and Class B stockholders are given preference as to water and price. (Tr. Rec., 82.) This corporation owns no irrigable lands to which any of its stock could possibly be appurtenant. A purchaser of water from this corporation, which water was placed to a beneficial use, could obligate the corporation to continue furnishing it, as the Prosole case holds, but this would not entitle the purchaser to shares of stock in the corporation. This is substantially what the trial court determined (Tr. Rec., 41) in declaring that "rights to water for irrigation of arid lands within this state are wholly distinct from rights which may be evidenced by corporations' stock certificates. A corporation, except in the case of a water supply, for municipal purposes, may not acquire a title to water for irrigation

except in cases where such corporation is also the owner of the land upon which such water is so used and so becomes appurtenant thereto."

It is believed that this Honorable Court has not taken into consideration that the appellant has not established that these various corporations own any irrigable land to which water may become appurtenant. If the corporations have not acquired any appurtenant water rights, then it must follow that no appurtenant water right attaches to any capital stock of a stockholder therein.

Berg vs. Yakima Canal Co., 145 P. 619.
See particularly pp. 621-622.

4.

The Court Has Apparently Misconstrued the Nevada Water Decree Adjudicating Rights On the Humboldt River

It will be observed from the decree (Tr. Rec., 100), that "neither the Humboldt Lovelock Irrigation, Light and Power Company, Young Ditch Company, Union Canal Ditch Company, or Old Channel Ditch Company are by said decree found or determined to have rights in or to the waters of said Humboldt River stream system, except that Union Canal Ditch Company was found to have certain rights in respect to lands not here involved, which rights are those referred to in the testimony of A. Jahn."

The court evidently recognizes this finding by declaring in its opinion (page 2) that "None of the ditch companies, so far as material here, was adjudged to have any right to divert or appropriate waters of the stream."

It will therefore be noted that these corporations not only did not own any irrigable land, as previously stated, but by the very court decree it was determined that they did not have any rights in or to the waters of the Humboldt River stream system. If they owned no irrigable land and no water, how may it be established in this case that these corporations owned any appurtenant water rights and were depriving the appellant of any? If the corporations owned no appurtenant water rights, then shares of stock in them would represent no such rights. How may appellant recover on the theory of a right to appurtenant water, if the stock it seeks to possess represents neither water nor a water right?

The court in its opinion (page 2), declares, "In the state decree, the right to use the water carried in the distribution systems of the ditch companies was adjudged to be appurtenant to the place of use." While this statement is undoubtedly accurate, may it be respectfully suggested that it may only apply to a holder of land who actually puts water to a beneficial use. It could not apply to these corporations, because, as has been shown, they hold no irrigable land, and they have performed no acts of beneficial use entitling them to a right to water or to

ownership thereof. Their general function is to transport and convey water for other people, including stockholders, to use; and it is not denied that by established authority and precedent, once water is so conveyed and appropriated and placed to a beneficial use by a recipient thereof, the corporations are obligated to furnish such transportation so long as use continues.

5.

It Is Respectfully Submitted That the Court Placed a Construction of the Deed From Taylor to Taylor, Inc., Not Justified By Conceded Facts

The court on page 2 of the opinion, observes that "The deed (from Taylor to John G. Taylor, Inc.) conveyed all the real and personal property of the grantor, together with *appurtenant* water rights, ditches, and canals, 'and all shares of stock of any water corporation *appurtenant* to said land or the waters from which are used or have been used in connection with the irrigation or cultivation thereof'." (Italics ours.)

It will be observed that the deed purported to convey APPURTENANT water rights and shares of stock of any water corporation APPURTENANT to said land. It will also be noted that the expression "the waters from which, etc.," refers to any water corporation APPURTENANT to said land.

It has been shown that none of the corporations whose

stock is here involved owns any water rights appurtenant to the land conveyed. Therefore, the deed could not possibly have conveyed or assigned any of the stock in controversy here. That this was the adopted construction of the deed by Taylor, by Taylor, Inc., and by the Reno National Bank is apparent, for never once, over a period of years, did any of them ever make demand upon Taylor for the delivery of the stock.

The statement in the opinion of the court (page 6), that "His (Taylor's) deed of conveyance to John G. Taylor, Inc., expressly included all water and distribution rights and all shares in water corporations," does not take into consideration that the conveyance was limited to APPURTENANT rights. It is also respectfully suggested that the further declaration of the court (Opinion, p. 6), that "The subsequent attempt of Taylor to pledge the shares are ineffectual, for they were no longer his to pledge," is a conclusion not justified by the facts and record, as above indicated.

6.

The Court Seems Not to Have Taken Into Consideration Essential Matters Upon Which the Trial Court Concluded In Favor of Appellees

On page 3 of the court's opinion, the following is stated:

"The trial judge appears to have believed that the stock in question might represent something of value other than

an interest in the irrigation systems. In his memorandum opinion, he calls attention to the circumstances that the articles of incorporation of the several companies do not disclose that they were organized for the sole or primary purpose of supplying water for the irrigation of any particular land. 'In the case,' said the court, 'of the Humboldt-Lovelock Irrigation, Light & Power Company, as indicated by its name, it was incorporated for other purposes in addition to that of storing and transporting water. Stock therein might necessarily have a value for reasons wholly distinct from the matter of supply water for irrigation of lands'."

This court apparently did not take into consideration other essential facts found by the trial court, namely, that "None of the corporations, the stock of which is here involved, appears to be the owner of irrigated lands. Such stock, therefore, does not present any element of interest in rights to water as such; particularly is this the case of the several ditch companies." (Tr. Rec., pp. 41-42.) The trial court also declared (Tr. Rec., p. 41), that "A corporation, except in the case of a water supply for municipal purposes, may not acquire a title to water for irrigation except in cases where such corporation is also the owner of the land upon which such water is so used and so becomes appurtenant thereto."

This court, in its opinion, appears to have made no

comment upon these factual and legal conclusions of the trial court.

7.

The Court Having Apparently Overlooked Some Essential Facts Established By the Record, Its Conclusions That These Corporations Are Mutual Water Companies, It Is Believed, Should Be Reconsidered

The cases of canal and ditch companies OWNING NO WATER RIGHTS, AND OWNING NO IRRIGABLE LAND, and which are only carrying companies, are to be distinguished from those having rights to water acquired through appropriation. This was the evident distinction made by the trial court as one reason for concluding against appellant's contention that the corporations, whose stock is involved here, are mutual water companies. An examination of the cases cited in support of the court's opinion herein will disclose, it is believed, that in every case in which the fact appears, the corporation involved had appropriated or owned water to furnish to stockholders.

In *Prosole v. Steamboat Canal Co.*, 37 Nev. 154, 140 P. 720, the opinion opens with the statement, "The appellant company, being the owner of the Steamboat Canal HAS FOR MANY YEARS BEEN ENGAGED IN THE BUSINESS OF DIVERTING WATER FROM

the Truckee River and delivering the same to and upon the lands under that canal for a valuable consideration."

In *Twin Falls L. & W. Co. v. Twin Falls Canal Co.*, 9 Cir., 79 F. (2nd) 431, it is stated that "Appellant APPROPRIATED FROM the waters of Snake River for this project, 3,000 second feet * * * on the river."

In re Thomas Estate, 147 Cal. 236, 81 P. 539, the ditch owners and owners of water rights "CONVEYED to the corporation, by deed of grant, the ditches then in use for the conveyance of the water, AND ALL THEIR WATER RIGHTS which may have accrued to said parties by their use of the waters of said creek for irrigation," and in consideration thereof, obtained corporate certificates of stock.

In *Ireton v. Idaho Irr. Co.*, 30 Ida. 310, 164 P. 687, "the contract provided that appellant should SELL TO ENTRYMEN WATER RIGHTS and shares of stock in the Big Wood River Reservoir Canal Company, Limited." The implication is plain that in order to sell water rights, the corporation must have owner or appropriated water.

In re Johnson's Estate, 64 Utah 134, 228 P. 748, involved the construction of a will. The court stresses a greater latitude of construction is justified in the case of a will as compared with a deed, but the fact as to whether the corporation had or had not owned or appropriated water to sell to stockholders is not disclosed by the opinion.

In *Yellow Valley Co. v. Associated Mortgage Investors*, 88 Mont. 73, 290 P. 255, the case was tried on an agreed statement of facts, and these are not set out in the opinion. Neither does the opinion disclose the fact herein discussed. The same observation is therefore made as in the preceding case cited.

In *Burnett v. Taylor*, 36 Wyo. 12, 252 P. 790, an application for a permit to APPROPRIATE water was made by and on behalf of the reclamation company. The corporation was given limited rights to DIVERT and USE this water, which it furnished to its stockholders.

In the case at bar, there was no evidence of diversion or appropriation of water by any of the corporations. There is nothing in the record to show that these stock holdings represented interests in irrigable lands or appropriated water. The most that may be claimed is, that as stockholders, they were entitled to a preferential right to the use of the water-transportation facilities at a minimum preferential cost, and to the use of flood waters from the reservoir, BUT ONLY TO SUPPLY A DEFICIENCY BASED UPON PRIOR USE AND APPROPRIATION BY THE LAND-HOLDER. Other land-holders, not stockholders, could use these same facilities if they paid the cost fixed by the Board of Directors, and if, like the stockholders, they had placed a given amount of water to a beneficial use.

Attention is further invited to the case of *Berg v. Yakima*

Valley Canal Co., 145 P. 619, and particularly p. 622, in which it is held that, "The stock in the extension company did not represent independent water rights, but only the right to carry water obtained from the Oligarchy Ditch Company. It was held that a deed conveying the land, together with all rights to use water for irrigating the premises, did not include stock in the extension company. This company owning no water right, but being only a carrying company, it is plain that the right to have water carried which the stock represented would not pass as appurtenant to the land. There would seem to be a distinction between stock in a ditch company which represented the right to the water which had been appropriated and owned by the company, and stock in a corporation which owned no water rights, and only carried water for its members which they owned, evidenced by certificates of stock in another corporation."

8.

Has the Court Taken Into Consideration Important Evidence In the Case In Determining With Appellant That In the Hands of Appellees, the Stock In Controversy Here Has Only a Nuisance Value?

On page 6 of the opinion, the court states, "In the hands of appellees, these shares possess no more than a nuisance value, but to appellant, they represent indicia of title and the essential right to participate in management." It is a definitely conceded fact that the common directorate

loaned $32,500 on this and other stock. There must be something more than a nuisance value in this. In fact, the appraised value, at the time of the loan, must have been greater than this, for it may be assumed that the bank required some margin of value in the security pledged in order to make the loan bankable. It will also be observed that the loan was made on the stock as such. It will further be noted that the independent value of this security was estimated by the Reno National Bank, sitting jointly with the Bank of Nevada, a predecessor of appellant. How may the Reno National now successfully contend, in the face of the record, that the stock only has a nuisance value, after deliberately appraising it as good and valuable security? If the Reno National would be foreclosed against such a claim, then certainly its assignee and the appellant would likewise be foreclosed.

Attention is also invited to the record-fact, that by authority of the Board of Directors, and otherwise, stock was issued to those NOT LAND OWNERS (Tr. Rec., 123, 124, 126, and 135); that it was pledged to Federal Farm Bank and others (Tr. Rec., 123, 126, 137); that "there have been some sales of the stock between one farmer and another. (Tr. Rec., 127.)

The Reno National, or its successor appellant, now desires to participate in management of these corporations and would deny to the Bank of Nevada such right in protection of the security so pledged. In the face of the

record, is it unreasonable to contend that the right to participate in management should accrue to the bank who holds the security? Also, in the face of the record, has not this right something more than a mere nuisance value?

9.

As a Further Ground for Re-Hearing, It Is Uurged, As Previously Contended In Appellees' Brief, That the Corporate Set-Up and By-Laws Establish That the Corporations Are Not Mutual Water Companies

While it is conceded that, as a general rule, the acts of a corporation often evidence and interpret its purpose, yet, it is respectfully submitted, that it appears from the authorities that this general rule does not apply in determining whether a so-called water-corporation is organized under general corporation statutes or whether it is organized as a mutual water with certain defined limitations and restrictions.

As is declared in a monograph on "Mutual Water Companies," Southern California Law Review, Volume XII, Number 2, January, 1939, page 194, "The form of the articles, by-laws, and the stock certificates have much influence upon the determination as to whether or not the corporation formed is a mutual water company." It is respectfully submitted that the court in its opinion (page 5), apparently disregarded "nomenclature and the formal recital of powers" and based its conclusion solely upon powers

"asserted or exercised." We again refer the court to p. 32, et seq., of appellees' brief, which we believe conclusively establishes by the record that neither the articles of incorporation, the by-laws nor the stock certificates indicate at all that any of these corporations were organized NOT for profit. In fact, the corporations referred to in the brief (page 32) all expressly provide and contemplate in their articles the payment of dividends out of profits. It is stated with confidence, that there is nothing in the corporate set-up, by-laws, or stock certificates which differentiates these corporations from those others organized under the general corporation laws of Nevada. As such, the stock is personal property not appurtenant to any land, not a covenant running with any land and not passing with a conveyance or mortgage of real estate. The rule is definitely stated by a respectable authority (cited in our brief, page 36), as follows:

> "A corporation may provide that the water-right shall be regarded as attached to the land, and shall pass only with it. In the absence of such provision, however, the stock is separate from the land and an execution sale of the land will not pass the stock."
>
> *Farnum on Water and Water Rights,* Vol. 3, Pages 2001-2002.

That the California courts of last resort have seriously considered, as a primal factor, the corporate set-up, the by-laws, and the stock certificates as determinative of the question as to whether a water-corporation is a mutual organization or not, is disclosed by the following cases:

Security Com. & Sav. Bank v. Imperial Water Co. No. 1, 193 P. 22, in which, on page 25, it is stated, "Under these circumstances, we think the proper course to pursue is to reverse the judgment without directions to enter judgment for defendants so that the complaint may be amended, if necessary, to show the true character of said stock and the existing facts regarding the by-laws of the corporation as above indicated."

Riverside Land Co. v. Jarvis, 163 P. 54, wherein the court appears to have determined the controversy, not unlike this case, through an examination and interpretation of the articles of incorporation, the by-laws, and the stock certificates. On page 59 of the opinion, the court states that, "The articles, by-laws, and certificate constitute the evidence of the contract between the parties. Taken together, they are in effect, an agreement between the stockholder and the company that the stock shall be transferable only with the land, and, conversely, that a transfer of the land shall pass to the grantor thereof the right to the stock, that is, the equitable title thereto."

In *Spurgean v. Santa Ana Val. Irr. Co.*, 52 P. 140, the court sets out in the opinion several of the by-laws and "rules" of the corporation and appears to have determined the case upon a construction of the articles, by-laws, "rules," and certificates of stock.

In *Smith v. Hallwood Irr. Co.*, 228 P. 373, the court held the stock in controversy "personal property"

and not appurtenant to the land, and based its conclusions upon the fact that the corporate set-up did not in express terms make the stock appurtenant.

See also, *Consolidated Peoples Ditch Co. v. Foothill Ditch Co.*, 269 P. 915, especially page 920.

John G. Taylor became a stockholder in the various corporations and was bound only by his contract with these corporations evidenced by the "articles, by-laws, and certificates." (*Riverside Land Co. v. Jarvis*, Supra.) He could not convey, transfer, mortgage, or hypothecate any of his stock and by so doing modify the express provisions of his contract. In other words, his stock, by the contract, not being appurtenant to the land, he could not make it appurtenant by violating his contract. Therefore, when he deeded to John G. Taylor, Inc., and conveyed "appurtenant stock," it could not have been the stock in controversy here, because by his contract with the corporations, evidenced by "the articles, by-laws, and certificate(s)," the stock was not made appurtenant to the land. (See Appellees' Brief, 31, et seq.)

WHEREFORE, appellees pray that a re-hearing may be granted herein.

Respectfully submitted,

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